report

meeting	**NOTTINGHAMSHIRE AND CITY OF NOTTINGHAM FIRE & RESCUE AUTHORITY**	
date	**23 February 2007**	agenda item number

REPORT OF THE CHIEF FIRE OFFICER

REVENUE BUDGET MONITORING

1. PURPOSE OF THE REPORT

1.1 The purpose of this report is to present to the full Fire Authority a report which was submitted to the Finance and Resources Committee relating to Revenue Budget performance for 2006/7 to the end of November 2006. The full report is attached as Appendix A.

1.2 This report makes certain recommendations as to the use of balances and underspends which require the approval of the full Fire Authority.

2. BACKGROUND

2.1 Budget monitoring for 2006/7 as a whole presents a picture of a relatively well managed financial position showing as it does a reasonably balanced position up to the end of November.

2.2 There are clearly a number of over and under spendings within the overall figure, but on balance the year end picture would have been expected to show the Authority spending at or about its allocated budget figure.

2.3 There are however two major areas which have been drawn to the attention of the Finance and Resources Committee which will significantly affect this position by the year end. Both of these areas are largely outside the control of the Fire Authority but nevertheless will affect the year end position.

2.4 Changes to pension regulations have meant that Retained Personnel have had access to the new fire fighters pension scheme since April 2006. Unfortunately, government have yet to produce such a scheme and therefore all the budget which had been allocated to the employer contributions for retained staff remains unspent and is likely to do so until the year end. This amounts to some £426,000. Whilst this creates a problem for the out-turn it would be prudent for some of this sum to be held as a reserve to provide for the fact that Retained staff will be entitled to backdate their membership of the scheme once it has been developed.

2.5 The largest problem relates to a change in the Capital Accounting arrangements for former operating leases which have been reclassified, on the advice of the Audit Commission, as finance leases. These leases were previously all charged directly to the Revenue Account but under the new arrangements are all charged as Capital

Financing which has different rules. The issues surrounding this are very complex and Finance and Resources Committee Members have been briefed in detail by the Head of Finance and the Treasurer and are satisfied with the reasons for this underspend. A copy of the Briefing paper given to Members is attached as Appendix B.

2.6 The underspending in question is of the order of £1.2m which raises the overall level of underspend predicted for the year end to approximately £1.7m including the pensions issue highlighted above.

2.7 The recommendations of the Finance and Resources Committee relate to the way in which some of this underspend should be dealt with which is:

2.7.1 The original transfer from balances to support Revenue is no longer required so this should be left in the balances.

2.7.2 An additional contribution to balances should be made in order to ensure that further contributions do not need to be made in 2007/8 and 2008/9 thus relieving the burden on Council Tax.

2.7.3 An earmarked reserve of £280,000 to be created and ringfenced to provide for Retained Staff to backdate their Membership of the pension scheme.

2.7.4 An earmarked reserve of £75,000 is created in respect of the Authority’s commitment to making CPD payments to Wholetime staff. (This requirement may increase).

2.7.5 A contribution of £300,000 to be made to support the 2006/7 Capital programme thus relieving the 2007/8 budget from additional charges.

2.7.6 A Community Safety earmarked reserve of £200,000 is created to enable further community safety initiatives and guard against grant reductions.

2.8 The budget for 2007/8 has been prepared on the basis of these recommendations being accepted.

3. FINANCIAL IMPLICATIONS

The financial implications are set out in full within the body of the report.

4. PERSONNEL IMPLICATIONS

There are no personnel implications arising from this report.

5. RISK MANAGEMENT IMPLICATIONS

The Budget Monitoring report and particularly the process of looking forward to out-turns has highlighted this problem to the Authority before it actually occurs. This enables action to be taken and for the situation to be managed proactively. This is a positive example of how financial risk is being managed.

6. EQUALITY IMPACT ASSESSMENT

An initial assessment has revealed there are no equality issues arising from this report.

7. RECOMMENDATION

That Members accept the recommendations of the Finance and Resources Committee as set out in paragraph 2.7 above.

8. BACKGROUND PAPER FOR INSPECTION

None

Paul Woods
CHIEF FIRE OFFICER

Appendix A

report

meeting	**NOTTINGHAMSHIRE AND CITY OF NOTTINGHAM FIRE & RESCUE AUTHORITY** **FINANCE AND RESOURCES COMMITTEE**	
date	**12 JANUARY 2007**	agenda item number

REPORT OF THE CHIEF FIRE OFFICER

BUDGET MONITORING REPORT - PERIOD 8 ENDED 30 NOVEMBER 2006

1. PURPOSE OF REPORT

To report to the Finance and Resources Committee on the financial performance of the Service in the year 2006/07 to the end of November 2006. This report analyses significant variances and highlights areas of concern.

2. BACKGROUND

Budget monitoring is a key aspect of financial management for the Authority. Regular reporting of spending against budget to Strategic Management Team and to Members is a check that spending is within available resources and, if necessary, allows for financial resources to be re-assigned to meet changing priorities.

3. REPORT

3.1 SUMMARY

3.1.1 The budget monitoring statement is showing an underspend to date of-£261k. This is made up of an overspend to date on non pensions of £195k and an underspend to date on pensions of -£456k.

3.1.2 The projected out turn variance for the year 2006/07 is a -£1,708k underspend on the general account.

3.1.3 The underspend to date of -£261k and the projected underspend of -£1,708k are made up of several key variances.

3.1.4 The full Budget Monitoring Statement is given as Appendix A to this report.

3.2 SIGNIFICANT VARIANCES

3.2.1 Wholetime Pay is underspent to date by -£289k. This is due to vacancies against the establishment. A re-costing exercise for the establishment of 569 employees has now been completed, and all the pay awards have been allocated from contingency. An outturn underspend of -£55k is assumed at this stage, based on the remainder of the year being at the full establishment of 569, and a reduction in the long service increment with effect from 1st October 2006. An earmarked reserve for the Continuing Professional Development scheme will be created at year end from the long service increment underspend.

3.2.2 The Pension Employer's Contribution budget is underspent by -£423k to date. This is for two reasons: firstly the budget assumption was that Retained Duty fire-fighters would be joining the pension scheme, however this option is not yet available; secondly there is an underspend on Operational Pay due to vacancies, which impacts on pension contributions. The projected outturn variance of -£343k is consistent with the projected pay outturn for the wholetime establishment. When Retained Duty fire-fighters are given the option to join the new scheme, contributions will be backdated. It is assumed at this stage that all Retained staff will join the scheme, and an earmarked reserve will be created at year end from the underspend.

3.2.3 Part time Operational Pay is overspent by £58k to date, mainly due to a high level of turnouts this year so far. In July the turnouts were 143% higher in the month than the average monthly turnout for the last 6 months. It is expected that this higher than usual level of activity will not continue and an outturn projection of a £14k overspend has been made.

3.2.4 Control Pay is overspent by £18k to date, due to temporary staff covering long term sicknesses. An outturn overspend of £8k is assumed at this stage, based on the remainder of the year being staffed at the full establishment of 26 and 1 additional post.

3.2.5 Administration and Clerical Pay is underspent by -£31k to date, due to vacancies in the establishment. An outturn underspend of -£20k is assumed at this stage based on the reminder of the year being under established.

3.2.6 Premises costs are overspent by £132k to date. Within this, building maintenance is overspent by £161k. This is due to a review of building maintenance which has resulted in a move away from reactive maintenance towards routine, contracted maintenance. The outturn overspend of £50k reflects this change. A review of Station budgets will be carried out, to reflect this change in policy in the 2007/08 budget. Business Rates is underspent by -£19k to date, due to a rating reassessment which resulted in a rebate, and a temporary underspend for the year of -£25k. Rent of premises is expected to overspend by £37k by year end mainly due to the increasing demand for meeting space outside Headquarters.

3.2.7 Operational equipment is overspent by £76k to date, £38k being due to expenditure on protective clothing for new recruits. The outturn overspend of £27k assumes a total of 66 new recruits for 2006/07. These budgets are volatile and will be closely monitored and variances will be reported.

3.2.8 Supplies and Services is overspent by £25k to date. This mainly relates to computer equipment. Included in this overspend is a charge of £51k, which has arisen from the change in accounting policy re IT maintenance in the 2005/06 final accounts. Based on last year's outturn, expenditure is expected to remain within the budget for the year. Work is being carried out with the IT Project Officer to closely monitor this budget and any variances will be reported.

3.2.9 Transport is overspent by £46k to date. An outturn overspend of £51k is anticipated on fuel due to the increases in prices. Travelling expenses are once again overspending, and an outturn overspend of £39k is anticipated. Travel expense claims for non-uniformed employees are now being closely monitored.

3.2.10 Support Services is overspent by £40k to date. The budget for public relations costs was converted to a pay budget this year but, due to delays in recruitment, the public relations service from the County Council was retained for the first quarter at a cost of £17k. There will be a corresponding underspend within Administrative Pay. An outturn overspend of £20k for Treasury Services is due to payment for the AXISE database, which was not included in the original budget.

3.2.11 Operating Lease Payments is showing an underspend to date of -£12k. A base budget review of both operating lease payments and capital charges has been completed and the projected outturns are now reported with the changed accounting treatment of fire appliances reflected (an underspend -£1,195k on Capital charges). This underspend is an issue for this year only as the provisional budget for 2007/08 already reflects the new base budget. The underspend on capital charges is due both to the changed accounting treatment of leased fire appliances and to underspends in previous years' capital programmes which have not been reflected in the original budget.

3.2.12 Station budgets are showing an overspend of £106k to date. They are monitored at a devolved level and budget managers are expected to spend within the budget allocated. The new Safety Services structure has been implemented, with responsibility for Station budgets moving to three Group Managers. Station Administrators are now monitoring and co-ordinating the budgets for the Group Managers and all Administrators have received appropriate training. The Finance Department is working with the Group Managers to review Station budgets and the outcome will be reported later in the year. Station Maintenance is overspending to date although, as reported above, the Procurement Officer is moving towards contracted maintenance. It is assumed that Stations will be advised to carry out only essential repairs to bring expenditure back into line with the budget. An outturn overspend of £44k is anticipated on contract cleaning, and £12k is anticipated for other premises related cost of which £5k relates to contractual budgets for window cleaning and grounds maintenance. The budgets for these contracted services have been understated for some time and additional funding has been requested in the 2007/08 budget. Cleaning materials, uniforms and stationery are currently overspending. These will be monitored at station level and stops should be put on budgets if needed, to avoid overspending. The current overspend will continue to be monitored closely.

3.2.13 Pension costs relating to ill health retirements and injury awards are showing an underspend to date of -£33k. An assessment of the likely outturn position will be made later in the year when the Personnel Section advise on the likely number of ill health retirements to come.

3.2.14 Trading activities in total show a surplus of -£51k to date. This is mainly due to Commercial Training exceeding the budgeted income target, which existed prior to the new partnership arrangement. An estimated outturn surplus of -£32k is reported at this stage, which takes account of the payment of 50% of the surplus to NatFire. Fire Equipment Maintenance is exceeding the budgeted target income and this has been reflected in the 2007/08 budget. An outturn surplus of -£90k is reported. The Princes Trust has now appointed two additional Team Leaders. The income for the additional teams will be reflected when the current courses have been completed. The phasing of the expenditure and income will be reviewed, however it is anticipated that the overall position will be that the Princes Trust will make a surplus of -£27k and this has been reported. The Marketing and Fundraising post has been vacant for a period of time and is covered by a temporary member of staff. Work will be carried out with Safety Services to ascertain the anticipated income and project costs to be reported.

3.2.15 The underspend to date in total on IRMP1 and IRMP2 is -£322k. The estimated outturn of £167k assumes that various work streams will commence before the end of the year. The negative budget on Arson Taskforce has been adjusted for in 2007/08. The Community Fire Safety budget of £66k has been allocated into the base budget in 2007/08. The remaining pay contingency is £462k, but this includes £391k for the shift change project and a proportion of this is to be allocated to base budgets to cover approved new posts.

3.2.16 The pension account is showing a significant overspend to date of £2,008k. A revised estimate of the pension account outturn has recently been sent to the DCLG. There are various reasons for the overspend against the original budget, but the main reason is the reduction in the employer's contribution rate after the original guidance was issued, which has the effect of reducing income to the pensions account thereby increasing the level of subsidy required from the DCLG.

3.2.17 It is proposed that the overall forecast underspend of -£1,708k is used for the following purposes:

3.2.17.1 The original budget assumed that a contribution of £400k would be required from Balances to support budget expenditure. This is not required and the contribution can be eliminated, thereby preserving Balances at £2.0m.

3.2.17.2 An additional contribution to Balances of £325k can be made. This will bring the level of Balances up to £2.4m, which is in excess of the level deemed to be necessary, but which will provide a "cushion" against unexpected events which may require Balances to be used.

3.2.17.3 An earmarked reserve of £280k can be created for the likely future requirement to pay backdated employers contributions into the pension account for Retained Duty employees (see paragraph 3.2.2 above).

3.2.17.4 An earmarked reserve of £75k can be created for the future requirement to make continuing professional development payments to operational employees (see paragraph 3.2.1 above).

3.2.17.5 A contribution of £300k from the revenue budget to finance part of the 2006/07 capital programme can be made. This will be as an alternative to borrowing or leasing as a means of financing capital expenditure.

3.2.17.6 An earmarked reserve of £200k can be created for future community safety initiatives.

4. RISK MANAGEMENT IMPLICATIONS

Budget Monitoring and the regular receipt of financial reports is key to managing one of the most significant risks to the organisation, that of financial risk. The process of budget monitoring is a key risk management control measure as are the management actions which are stimulated by such reporting. Formal action planning is not necessarily considered to be the appropriate response to budget variances. Instead finance division staff work collaboratively with budget holders towards improving financial performance.

5. FINANCIAL IMPLICATIONS

The financial implications are set out within the body of the report.

6. PERSONNEL IMPLICATIONS

There are no personnel implications arising from this report.

7. EQUALITY IMPACT ASSESSMENT

There are no equality issues arising from this report.

8. RECOMMENDATIONS

That the Committee recommend that the proposals for managing the forecast underspend, as detailed in paragraph 3.2.17, be submitted to the Fire & Rescue Authority for approval.

9. BACKGROUND PAPERS FOR INSPECTION

None.

Paul Woods
CHIEF FIRE OFFICER

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Appendix A

MONITORING STATEMENT "N" - 1st APRIL 2006 TO 31st NOVEMBER 2006

CATEGORY		Annual Budget	Current Profile	Actual to Date	Variance Profile	Estimated Outturn	Outturn Variance
		£ 000's	£ 000's	£ 000's	£ 000's	£ 000's	£ 000's
EMPLOYEES							
WHOLETIME OPERATIONAL PAY							
	Pay	16,705	11,136	10,890	-246		
	Nat Ins	1,307	871	916	45		
	Overtime	191	164	238	74		
	Bank Holidays	226	226	129	-97		
	Other	140	93	28	-65		
		18,569	12,490	12,201	-289	18,515	-55
WHOLETIME PAY ERS PENSION CONT							
	Emp Cont to Pensions - old scheme	3,686	2,457	2,178	-279		
	Emp Cont to Pensions - new scheme	317	184	40	-144		
		4,003	2,641	2,218	-423	3,660	-343
PART TIME OPERATIONAL	Retaining Fees	934	545	401	-144		
	Drills	505	295	359	64		
	Turnout Fees	606	354	297	-57		
	Tunout Hours	124	72	110	38		
	Disturbance Allowance	75	44	98	54		
	Holiday Back Pay	195	114	126	12		
	Community Safety	67	39	102	63		
	Attendance Fees	104	60	24	-36		
	Other Work (inc. Aux Crewing)	241	182	212	30		
	National Ins	129	75	109	34		
	Super Annuation						
		2,980	1,780	1,838	58	2,994	14
CONTROL STAFF	Pay	802	534	516	-18		
	Nat ins	57	38	42	4		
	Overtime	28	16	23	7		
	Supn	68	46	71	25		
		955	634	652	18	963	8

		Annual Budget £ 000's	Current Profile £ 000's	Actual to Date £ 000's	Variance Profile £ 000's	Estimated Outturn £ 000's	Outturn Variance £ 000's
ADMIN, CLERICAL & COOKS	Pay	3,146	2,107	2,125	18		
	Nat ins	234	156	153	-3		
	Overtime			14	14		
	Supn	414	274	239	-35		
	Pension Recharges			9	9		
	Temp Admin Pay	45	30	2	-28		
	Temp Admin NI	3	2		-2		
	Temp Admin Sup	6	4		-4		
		3,848	2,573	2,542	-31	3,828	-20
OTHER EMPLOYEE EXPENSES							
	Staff Training	369	223	182	-41	369	
	Bounty Scheme	35	23	23		35	
	Other	101	66	106	40	101	
		505	312	311	-1	505	
PREMISES	Building Maintenance	367	214	375	161	417	50
	Electricity	35	20	11	-9	35	
	Gas	51	14	4	-10	51	
	Rent Premises	63		14	14	100	37
	Business Rates	465	370	351	-19	440	-25
	Contract Cleaning	53	31	24	-7	53	
	Other	78	56	58	2	78	
		1,112	705	837	132	1,174	62
OPERATIONAL EQUIPMENT	Specialist Equipment	184	111	128	17	198	14
	Breathing Apparatus	57	33	41	8	50	-7
	Protective Clothing	73	44	82	38	100	27
	Other	15	9	22	13	15	
		329	197	273	76	363	34
OTHER SUPPLIES & SERVICES							
	Comms Maint & Purch	36	18	13	-5	36	
	Clothing Shoes & Uniforms	54	30	32	2	48	-6
	Stationary	51	30	31	1	51	
	Audit Fees	34	23	24	1	34	

		Annual Budget	Current Profile	Actual to Date	Variance Profile	Estimated Outturn	Outturn Variance
		£ 000's	£ 000's	£ 000's	£ 000's	£ 000's	£ 000's
	Phones General	213	141	147	6	213	
	Comms Licenses & Rentals	149	74	38	-36	149	
	Computer Eqpt Purchase	523	359	433	74	523	
	Insurances	543	543	476	-67	543	
	Office Equipment	104	58	65	7	104	
	Catering Contract/Equipment	58	34	51	17	58	
	Consultancy Fees	113	89	97	8	138	25
	Postage	32	22	15	-7	32	
	Subsistence Allowance	46	27	30	3	46	
	Travel- Home To Base	58	38	44	6	58	
	Catering/Conferences & Members Expenses	37	23	17	-6	37	
	Other	206	143	164	21	206	
		2,257	1,652	1,677	25	2,276	19
TRANSPORT	Workshop Charges	571	333	343	10	570	-1
	Fuel	240	140	186	46	291	51
	Vehicle Leasing	91	53	21	-32	91	
	Travelling Costs	276	165	188	23	315	39
	Other	67	39	38	-1	54	-13
		1,245	730	776	46	1,321	76
SUPPORT SERVICES	Treasury	105	76	96	20	125	20
	Occupational Health	86	46	74	28	86	
	Regional Mang Board Costs	66	39	3	-36	66	
	Other	238	104	132	28	238	
		495	265	305	40	515	20
CAPITAL FINANCING	Operating Lease Payments	297	296	284	-12	297	
	Finance Lease Ext & Term						
		297	296	284	-12	297	
INCOME	Fire Certificates	-6	-3		3	-6	
	Car Leasing Contribution	-58	-39	-30	9	-58	
	Store / Clothing Sales	-2	-1		1	-2	
	Special Services	-20	-13	1	14	-20	
	Meals & Refreshments	-15	-10	-6	4	-15	
	Environmental Income	-16	-11		11	-16	

		Annual Budget £ 000's	Current Profile £ 000's	Actual to Date £ 000's	Variance Profile £ 000's	Estimated Outturn £ 000's	Outturn Variance £ 000's
	Other	-41	-22	-40	-18	-41	
		-158	-99	-75	24	-158	
HQ BUDGETS		**36,437**	**24,176**	**23,839**	**-337**	**36,253**	**-185**
ADMIN, CLERICAL & COOKS	Cooks Pay	125	83	90	7	125	
		125	83	90	7	125	
OTHER EMPLOYESS EXPENSES	Other	11	7	8	1	11	
		11	7	8	1	11	
PREMISES	Station Maintenance	54	29	59	30	60	6
	Electricity	65	38	32	-6	65	
	Gas	52	31	10	-21	52	
	Contract Cleaning	106	79	112	33	150	44
	Other	21	9	35	26	33	12
		298	186	248	62	360	62
OPERATIONAL EQUIPMENT	Protective Clothing	90	52	46	-6	90	
		90	52	46	-6	90	
OTHER SUPPLIES & SERVICES							
	Clothing Shoes & Uniforms	53	31	47	16	53	
	Stationary	6	4	34	30	6	
	Phones General	19	9	11	2	19	
	Other	67	41	33	-8	67	
		145	85	125	40	145	
INCOME	Other	-3	-2		2	-3	
		-3	-2		2	-3	
STATIONS BUDGETS		**666**	**411**	**517**	**106**	**728**	**62**
ANNUAL PENSIONS	Injury Awards	239	180	207	27	239	
	Ill Health Deposit	356	237	91	-146	356	
	Ill Health Charges	251	167	253	86	251	
		846	584	551	-33	846	
TRADING ACCOUNTS	FEM	38	43	-55	-98	-52	-90
	PRINCE'S TRUST	42	52	72	20	15	-27
	COMMERCIAL TRAINING	-16	6	-22	-28	-48	-32
	MARKETING & FUNDRAISING	-48	-55		55	-48	

		Annual Budget £ 000's	Current Profile £ 000's	Actual to Date £ 000's	Variance Profile £ 000's	Estimated Outturn £ 000's	Outturn Variance £ 000's
		16	46	-5	-51	-133	-149
CAPITAL CHARGES	Depreciation and Interest	2,985				2,985	
	Asset Management Revenue	-719				-719	
	Minimum Revenue Provision Appropriation	-439				-1,634	-1,195
	External Debt			92	92		
		1,827		92	92	632	-1,195
OTHER	External Interest	-150	-100	-135	-35	-150	
	Revenue - Balances / Unallocated	-400				-400	
	Government Grant	73				73	
	General Reserve						
	Base Budget Review Savings	-59				-59	
	To Ear Marked Reserve						
	From Ear Marked Reserve	-329	-329	-329		-329	
	Surp/Deficit on Collection	-68	-45	-48	-3	-68	
		-933	-474	-512	-38	-933	
IRMP 1	Abandoned Vehicles	86				35	-51
	Arson Task Force	-93				-93	
	Community Fire Safety	66				66	
	Co-responder	109				45	-64
	Cross Border Incidents						
	Corporate						
		168				53	-115
IRMP 2	Working with Young People	70				30	-40
	DDA	10				10	
	Specialist Equipment	20				20	
	Fire Setters Intervention	54				54	
		154				114	-40
CONTINGENCY	Pay Award Contingency	462				462	
	Community Fire Safety Contingency	84				84	
	Contingency Regional Control	20				20	
	Contingency Driving at Work	70					-70
	IT Support 24/7	30				13	-17

		Annual Budget	Current Profile	Actual to Date	Variance Profile	Estimated Outturn	Outturn Variance
		£ 000's	£ 000's	£ 000's	£ 000's	£ 000's	£ 000's
	I P D S						
		666				579	-87
TOTAL INCLUDING PENSIONS		**39,847**	**24,743**	**24,482**	**-261**	**38,139**	**-1,708**
PENSIONS	Annual Pensions	4,849	3,225	2,769	-456	4,506	-343
		4,849	3,225	2,769	-456	4,506	-343
TOTAL EXCLUDING PENSIONS		**34,998**	**21,518**	**21,713**	**195**	**33,633**	**-1,365**

PENSIONS ACCOUNT

		Pension Account 000s
INCOME	Pension Contributions Employers (Old Scheme)	-2,208
	Pension Contributions Employers (New Scheme)	-43
	Pension Contributions Employees (Old Scheme)	-1,125
	Pension Contributions Employees (New Scheme)	-33
	Ill Health Charges	-253
	Transfer Values Received	-83
	Refund of Contributions	-4
		-3,749
EXPENDITURE	Annual Pensions	3,520
	Annual Pensions - Widows	183
	Annual Pensions - Children	10
	Pension Inc Payments	1,311
	Pensions - Lump Sum	1,289
	Transfer Values Paid	26
		6,339
GOVERNMENT GRANTS RECEIVED		-582
NET DEFICIT / (SURPLUS) - BALANCE FROM / (TO) DCLG		2,008

Appendix B

Briefing Note Members
Budget Underspendings 2006/7

The latest Revenue Budget Monitoring Statement shows an underspending approaching £1.3m projected for the Year End. This is clearly a serious matter which has been exercising my brain (and Sue's) for a little while.

We have got to the bottom of the problem but it leaves us with something of a dilemma. I should add that this is a highly complex accounting issue which I will endeavour to explain.

All of the underspend relates to that part of the revenue budget which is set aside for the financing of debt and leasing.

There are three issues:

1. Capital Slippage not spent (with no subsequent plans due to duplication)
2. Prior financing of capital from revenue with no subsequent reduction in base budgets. (Identified already through base budget review)
3. Re-categorisation of operating leases as finance leases.

The first issue is simple but significant and relates largely to issues in IT. Ivan had described some projects in such a way that it was difficult (near impossible) for Peter Mann to determine what they were. Due to the temporary nature of Pete's appointment he would have assumed that these projects would go ahead when Ivan returned and therefore left them in the budget. He then added his own development priorities to the budget not realising that some of those were exactly the same as those described previously by Ivan. An example of this is Ivan put £250,000 in the budget for "Personal Data Ports" and Peter put in £300,000 for mobile computing. Both of these related to the provision of PDAs and laptops but we had revenue budget cover for both when in fact we only needed cover for one.

The second point is a problem related to timing. When the base budget is constructed the revenue effects of capital are based on the know commitments plus plans for the coming year. If however we have an underspend (as we did) then we may opt to finance some of the capital programme directly from the revenue account (RCCO) rather than from borrowing. This has the advantage of effectively reducing the requirement to repay borrowing and pay interest in future years. Unfortunately the decision to finance from RCCO is made after the budget is set and therefore there will always be a surplus of budget created for the coming year. In this case however the issue was allowed to run for more than one year as the effect was somewhat disguised by overspendings elsewhere in the budget and it was only when a base budget review was carried out that this issue was revealed. This issue is made worse by the fact that the timing of payments is "back end loaded" and therefore the problem does not reveal itself within the budget until now.

The third issue is much more complex and impacts across budget years and into 2007/8 and 2008/9 and beyond.

It is a simple truth that the Fire Authority can only spend in any given year from three sources:

Revenue Budget (the precept)
Balances/Reserves
Borrowing (for capital)

This needs to be kept in mind throughout the next section.
An operating lease for a fire appliance valued at say £150,000 will cost the authority about £20,000 per annum over a period of 12 years and this £20,000 will charged directly to the revenue account as it represents real cash flowing out of the organisation.

A finance lease for the same appliance will still cost £20,000 per annum but he accounting is very different.

The £20,000 is split broadly between Notional Principal and Notional Interest let's say £12,500 Principal and £7,500 interest.

The Interest is charged directly to the revenue account and the principal to the balance sheet (it reduced the notional value of the leased asset).

The balance sheet than makes a charge to the revenue account for what is known as MRP which is calculated at 4% of the capital value i.e. in this case £6,000 in the first year.

This creates a series of shortfalls as illustrated in the following table:

	Capital Value	Operating Lease Charge	Interest Charge	MRP Charge	Total Charge to Revenue	Actual Cash Less Revenue Charge
0	150,000	20,000	7,500	6,000	13,500	6,500
1	137,500	20,000	7,500	5,500	13,000	7,000
2	125,000	20,000	7,500	5,000	12,500	7,500
3	112,500	20,000	7,500	4,500	12,000	8,000
4	100,000	20,000	7,500	4,000	11,500	8,500
5	87,500	20,000	7,500	3,500	11,000	9,000
6	75,000	20,000	7,500	3,000	10,500	9,500
7	62,500	20,000	7,500	2,500	10,000	10,000
8	50,000	20,000	7,500	2,000	9,500	10,500
9	37,500	20,000	7,500	1,500	9,000	11,000
10	25,000	20,000	7,500	1,000	8,500	11,500
11	12,500	20,000	7,500	500	8,000	12,000
12	0	20,000	7,500	0	7,500	12,500
Total Shortfall						123,500

This shows that over a 12 year life, charges to the revenue account will fall short of the actual payments by £123,500 per appliance (we currently have 40)

In any given year however the shortfall will be £9,500 per appliance, which is about £400,000 across the fleet in this example.

What this means in budget terms is that we have budget for £20,000 per truck when in fact the charge to revenue will only be £10,500 on average which gives us a budget surplus.

The tricky question is what to do about it. There are three options:

Solve the problem from now by increasing our MRP so that MRP + actual interest equals the lease rental.

Solve the problem from now by increasing our MRP so that MRP + actual interest equals the lease rental. And seek to address the fact that we have not made full provision in prior years.

Carry on as we are

If we were to follow option 1 we would need to increase our MRP contributions by about £350,000 from 2007/8 which would give us an immediate budget problem which would undermine all of our budget thinking to date. This may seem attractive in terms of not building up a problem in later years but it is quite damaging in the short term.

The second option carries all the problems of the first but has the advantage that it clears down any backlog from previous years as well and soaks up the underspend in 2006/7.

Option 3 requires a little more thought. What are the fundamental assumptions that underpin the current recommended practice of calculating MRP and how do we stack up against them?

As the reduction in principal is always a percentage of the value outstanding then effectively it is never paid off. In fact it would take about 250 years to reduce a debt of £150,000 to zero using this method. However this substantially reduces over 25 years which might be used as a proxy.

Interestingly this “rule” applies to all Local Authorities and all Capital Accounting, so if we are going to make a change for these assets then really we should make a change for them all.

If we do this however we will be “out on a limb” with what all other Local Authorities and Fire Authorities are doing AND putting ourselves under unreasonable budget pressure.

I have consulted with the Authority Treasurer who has examined all the calculations and is also of the view that doing nothing is the best option for a number of reasons:

i) Creates a budget problem in 2007/8 and beyond when we are the only authority attempting to rectify this problem.
ii) CIPFA are substantially revising this whole area in 2008 which may negate anything we do in the short term.
iii) The underspend is genuine windfall and would be better used supporting the balances to avoid having to look to taxpayers to do this in 2007/8 and 2008/9.

Dealing publicly with this underspend will be difficult in that it is unlikely that the media will understand it.

An examination of our asset lives shows that on average they are 27 years across the whole portfolio.

Neil Timms
Head of Finance and Resources.