AGENDA ITEM:

REPORT TO:	**MERSEYSIDE FIRE & RESCUE AUTHORITY BUDGET MEETING**
DATE:	**21ST FEBRUARY 2008**
REPORT NO.	**CFO/46/08**
REPORTING OFFICER:	**EXECUTIVE DIRECTOR OF RESOURCES**
CONTACT OFFICER:	**KIERAN TIMMINS, EXTN. 4108**
OFFICERS CONSULTED:	**CORPORATE LEADERSHIP TEAM**
SUBJECT:	**FINANCIAL REVIEW 2007/08 – OCTOBER TO DECEMBER REVIEW**

Purpose of Report

1. To review the financial position, both revenue and capital, for the Authority for 2007/08. The Authority receives regular comprehensive financial reviews during the year which provide a full health check on the Authority's finances. This report updates the last financial review report CFO/200/07 and covers the period up to December 2007.

Recommendation

2. It is recommended that members:

   2.1 Approve the variations to the 2007/08 revenue budget and capital programme outlined in Appendix A to C.

   2.2 Instruct the Executive Director of Resources to work with budget holders to maximise further savings for 2007/08.

Executive Summary

Revenue:
The Authority has a detailed medium-term financial plan. The key elements of this are :-

- The use of smoothing and modernisation reserves to part finance the 2007/08 budget and enable the modernisation of the service to give time to deliver medium and long-term savings.
- The medium-term savings are being achieved mostly by staffing efficiencies, which will be achieved without redundancy by using natural retirement rates and if required VER/VS.

The Authority is on target to deliver the 2007/08 budget savings (Dynamic staff savings £4.0m).

The Authority is on line to deliver the structural changes in its workforce to maintain savings in the longer term but some work remains outstanding to deliver the full savings target of £5.2m in 2008/09.

The only significant movement on the budget since the last financial review report relates to the drawdown of £0.246m from the pay inflation contingency to cover the 2.475% 2007/08 non uniform pay award. The total budget requirement remains at the original budget level of £69.595m, (appendix A outlines in detail all the budget movements to date). A small revenue saving is forecast, £0.10m, and the Executive Director of Resources will work with budget managers to try and deliver further savings before the year-end.

Capital:
£4.97m of the 2007/08 capital programme is being re-phased into future years. The updated 5 year programme has increased by £1.1m to £32.6m following the approval of the new Kensington Fire Station, net increase £0.55m, and the increase in the number of smoke alarms to match the higher HFSC, £0.45m. The revised Capital Programme is outlined in detail in Appendix B and C.

Reserves & Balances:
The general balance remains unchanged at £2.0m (3% of net budget).

Treasury Management:
Short-term interest rates reduced to 5.50% in December 2007 and 5.25% in February 2008. Longer term loans of £10m have been taken out in the period at an average rate of 4.63%. All borrowings are in line with the Treasury Management Strategy and the prudential indicators set by the Authority.

Internal Audit:
Audit continues to work against the approved programme. The audit on Payroll has been completed and a copy of the audit report has been attached as Appendix D for members' information. Audit reports are being prepared on the creditors and income systems. An updated Internal Audit Plan for 2007/08 is attached as Appendix E.

Financial Processes:
Performance in Financial processes remains strong.

Reason for Report

3. To enable the Authority to monitor its income and expenditure levels against its budget on a regular basis throughout the year to ensure effective financial management.

4. This report is the review of the Authority's position up to the end of December for the financial year 2007/08 (April – December 2007).

5. In order to ensure that the financial reviews provide a regular and effective financial health check on all aspects of the Authority's finances the following structure has been adopted.

Financial Review Structure

Section	Content
A	Current Financial Year Review (Revenue Budget, Capital Programme and movement on Reserves)
B	Treasury Management Review
C	Internal Audit
D	Financial Process Monitoring/Performance Indicators
E	New Finance & Payroll System progress report

(A) Current Financial Year – 2007/08

6. The purpose of the financial review report is to provide members with an assurance that the current budget remains robust and is consistent with the approved planned expenditure. The report also provides an indication if actual expenditure and income for the year will remain within the current budget, or if necessary, identifies appropriate corrective action.

7. The attached Appendix A to this report summarises the budget movements since the last financial review report. The net budget requirement remains at £69.595m which is consistent with the original budget. The most significant budget movement has been the allocation from the pay contingency provision of £0.246m to the non uniform employee's budget following the settlement of the 2007/08 pay award at 2.475%. The remaining budget movements reflect the realignment of resources based on actual spend and the use of reserves.

8. Each month budget managers receive a statement on the actual spend against budget for the year and an assessment is made on the potential year-end position. As total employee costs make-up over 80% of the Authority's revenue budget they are the most risk critical areas in terms of financial management and are therefore monitored extremely closely. Progress is also monitored against the achievement of budget saving targets, the most notable being the cumulative £4.0m dynamic staff saving target in 2007/08. Based on expenditure up to 31 December, 2007, the following forecast variations have been identified by officers:

Employee Costs & Staff Secondment Income;

9. Uniform employee costs / Dynamic Staff Saving Target – **no variance**. Uniform retirements have continued in line with original expectations. **Overall the Authority is well on line to deliver its dynamic staff savings target for 2007/08 of £4m.** *(a more detailed update on the dynamic staff saving target is provided in paragraph 21 of this report)*

10. Non Uniform employee costs – anticipated **saving £0.19m**. The Authority budgets for a full establishment at top of the grade but due to vacancies and some staff being on a point below the top of their grade a £0.19m saving is anticipated against the £10.9m budget.

11. Long Service Increments, LSI, & Continual Professional Development payments, CPD, – **anticipated £0.40m overspend**. Report CFO/186/07, Policy and Finance Committee 18th October, 2007, informed members that the NJC had reached a formal agreement on the introduction of the CPD scheme from 1st July, 2007. The terms of the agreement will result in an overlap of CPD payments for June 2006/July 2007, and transitional LSI payments. This is likely to result in an additional cost of £0.40m in this financial year.

12. Seconded Staff Income – anticipated **increase in income of £0.30m**. The Authority's classification as an excellent organisation means MFRA staff are often asked to provide help and support to other organisations. The success of the MFRA brand has seen a significant increase in the level of secondment income well beyond that estimated in the current budget, £0.10m, and the latest estimated outturn figure is in excess of £0.40m, an increase in income of £0.30m.

13. Ill health retirement penalty charges – potential **£0.31m overspend.** Under the 2006/07 pension rules the Authority is penalised if any fire fighter retires from the service on ill health grounds. For those retirements classified as "upper tier" (unable to work in any capacity in the future) the penalty is four times pensionable salary. Fire fighters who are retired on ill health grounds but are assessed as being capable of being employed in some capacity in the future are classified as "lower tier" retirements and the penalty is two times the pensionable salary. The Authority is allowed to spread the cost of the penalty charge out over a three year period. As a rough guide pensionable pay is assumed to equate to £28k. The table overleaf details the current forecast for ill health retirements, however it is important to note that the financial forecasts are extremely sensitive to small changes in retirement numbers and/or classifications;

Forecast Ill Health Retirement Numbers & Penalty Charges

	2006/07 Actual	2007/08 Actual to Dec 07	2007/08 Total Forecast	2008/09 Forecast	2009/10 Forecast
Lower Tier (no.)	2	3	5	8	8
Upper Tier (no.)	8	3	5	2	2
Penalty (£000)	389		389	389	
			270	270	270
				224	224
					224
Total Penalty Charge			659	883	718
Budget (£000)			350	524	524
Budget Shortfall (£000)			309	359	194

14. Job Evaluation Provision – **one-off saving £0.22m**. The 2007/08 budget included £0.30m for the impact of job evaluation implementation. The job evaluation exercise is currently being finalised and is unlikely to have any financial impact this year resulting in a one-off saving of £0.22m.

15. The net impact of the variations in paragraphs 9 – 14 is an overall nil variance.

<u>Other Variations</u>

16. Anticipated re-phasing of £4.97m on the current capital programme into future years has had a favourable impact on the revenue account as interest and borrowing costs will be lower than budgeted. The estimated **saving in the year is currently forecast at £0.20m.**

17. The Authority's ICT partners Telent delivered savings of £0.146m in 2006/07, and are targeted with delivering £0.276m in 2007/08 and £0.407m in future years. Against this challenging target Telent have confirmed savings of £0.176. Whilst future efficiencies are being worked up it is unlikely the work will be fully in place before the year end. There is therefore a shortfall against the target of £0.100m.

18. The current uniform budget is £0.377m but due to a significant investment in person protective equipment (PPE) and other specialist clothing in the year a one-off overspend in the uniform budget of £0.075m is forecast. This can be contained within the overall operational appliances and equipment budget, mainly from a virement from an underspend on the foam concentrates budget line.

Revenue Summary Position:

19. The position can be summarised as follows:

	Forecast Year-End Variance £M
Employee costs/income	
Uniform/ Dynamic staff saving position	0.00
Non uniform saving	-0.19
LSI/CPD impact	0.40
Increase in seconded staff income	-0.30
Increase in ill health retirement penalty provision	0.31
Job Evaluation provision saving	-0.22
	-0.00
ICT provision to offset risk on saving target	0.10
Cost of borrowing / interest saving	-0.20
Total anticipated saving	**-0.10**

20. The **overall position is broadly neutral with an anticipated net saving of £0.10m identified in this financial review report.** In addition to the above the Chief Fire Officer has asked all managers to control expenditure in their areas closely and it is hoped that such proactive management will allow the identification of further efficiencies during the closure of accounts.

Dynamic Staff Saving Target £4.0m

21. Members will recall they have set a budget and medium term financial plan that contains significant saving targets most notably a Dynamic Staff Saving Target £4.00m to be achieved during 2007/08, rising to £5.20m in 2008/09. This target was based upon maximum achievable savings by utilising natural retirement rates over the 2006/07 to 2008/09 period. Previous financial review reports informed members that as a result of approved structural changes implemented in 2006/07 the level of net savings achieved to date was over £3m, leaving a **further £0.90m to be identified this year**.

Uniform retirements have continued in line with original expectations. **Overall the Authority is well on line to deliver its dynamic staff savings target for 2007/08 of £4.00m.** However, clearly, whilst the saving is being delivered in "cash" terms this is only sustainable if the organisation delivers structural efficiencies that match the establishment to the actual numbers of people. The Authority has a large number of efficiency changes, which have been delivered since 2006/07 these include:-

- LLAR stations
- Community Safety Department Restructure
- Senior Officer Review
- Retained Appliances.

22. The Authority at its meeting on 22 January, 2008, report CFO/25/08 approved the extension of the LLAR system to 2 further stations. Officers are confident that this combined with the implementation of the Bromborough HAZMAT pump, the primemover staffing realignment at Kirkdale and Birkenhead stations, can deliver the establishment structural changes to confirm the delivery of the £4.00m dynamic staff saving target required this financial year. However, members are aware the accumulative target increases in 2008/09 to £5.20m and further organisational structure changes will be necessary to deliver the increased staff saving target. The Executive Director of Resources will continue to monitor actual staff numbers to ensure the service will deliver in "cash" terms the dynamic staff saving requirement

Other Potential Issues

23. **Home Fire Safety Checks, HFSC, -** Performance on the HFSC programme has been outstanding and the number of visits carried out in 2007/08 may be double that assumed in the budget, possibly exceeding 100,000 this year. The Authority's policy in 2007/08 is to capitalise the alarm installation costs associated with HFSC, (estimated at £0.50m on c50,000 HFSCs). Because of the actual number of HFSCs expected in 2007/08 this may increase the capitalisation of current salary costs from £0.50m to £1.00m, resulting in a **net favourable revenue variance of £0.5m**. However, it would result in an increase in borrowing charges of £80k p.a. The policy and approach on this is being reviewed and will be reported in the closure of accounts.

24. **Ill Health Retirement Penalty Reserve** – This report identified a potential overspend on ill health retirement penalty charges of £0.31m in 2007/08 and potentially +£0.50m between 2008/09 – 2009/10. However, this is extremely sensitive to small changes in activity levels and classification of retirements. This projection is being reviewed in detail. The Authority is also bound by the medical opinion of the Independent Qualified Medical Practitioner where they determine that an employee is permanently disabled for duty.

Capital

25. The Authority has an approved 5 year capital programme and this financial review report will outline in detail the proposed changes to the 2007/08 programme, and then consider the implication of these issues and other changes on the 5 year programme.

2007/08 Capital Programme

26. Attached as Appendix B is the latest 2007/08 capital position statement. Since the last financial review report the 2007/08 programme has increased by approximately £0.23m funded from revenue contributions and brought forward capital from future years. However, the biggest change is planned re-phasing from 2007/08 to 2008/09 of £4.97m. The 2007/08 programme changes are summarised below;

	£m
Qtr 2 Financial Review	11.66
Increase in programme via RCCO/Brought forward spend	0.23
Re-phasing into 2008/09	-4.97
Qtr 3 Revised 2007/09 capital programme	6.92

27. An analysis of the £4.97m re-phasing shows that £3.5m relates to the building and land programme, £0.2m for operational equipment, £0.15m for ICT and £1.1m for vehicles.

<u>£4.97m Re-phasing into future years</u>:

28. **Building and land programme** - The Estates service is in the process of revising the station refurbishment programme and updating the Authority's Asset Management Plan, consequently £0.73m of the fire station refurbishment budget has been re-phased for future years. Discussions are on-going with partners with regard to the refurbishment of Toxteth station, the £0.70m scheme will not commence in 2007/08. The £1.00m approved for land purchases for the PFI project is no longer required and as per report CFO/169/07 (Authority meeting 13 September, 2007) the budget will be re-phased for 2008/09 to partially fund a new fire station at Kensington. Officers are still in negotiations to finalise a site for the Marine Fire 1 accommodation and as a result £0.29m spend is being re-phased into 2008/09. The remaining re-phasing is made-up of other office and operational accommodation and refurbishment schemes.

29. **Operational Equipment** – Officers are continuing to work on finalising the required specification for the proposed incident command unit, the £0.20m scheme will not commence in 2007/08.

30. **ICT** – Indicative tenders have been received for the knowledge management portal and officers are currently in detailed discussions with the potential suppliers. The £0.15m planned for 2007/08 will now be phased into 2008/09.

31. **Vehicles** – The time period between specifying, ordering and getting delivery of specialist vehicles can be over 12 months. The budget assumed 5 Water Tender Ladder appliances could be delivered in 2007/08, however this is now unlikely and delivery on the vehicles is not expected until after the end of the financial year, £1.00m slippage into 2008/09. The latest vehicle prices issued by Firebuy have indicated increases between 36% for the refurbished combined pump ladders and 20% for the water tender ladder vehicles. If the Authority wished to continue with the original 5 year vehicle replacement plan the capital programme would require an additional £0.97m. The Assistant Chief Fire Officer will review the current plan and report back to members on this matter, until then **the capital programme assumes the vehicle replacement strategy can be delivered within the available budget**.

32. All funding associated with the proposed £4.97m slippage can be re-phased to reflect the revised programme.

2007/08 – 2011/12 Approved Capital Programme

33. Attached as Appendix C is the updated 5 year capital programme that reflects the revised phasing of schemes, any new approved schemes and any funding changes. The changes can be summarised as follows:

	£m
Original 2007/08 – 2011/12	26.65
Add 2006/07 slippage, (April – June Fin Review CFO/153/07),	4.90
	31.55
New Kensington Fire Station – overall increase	0.55
HFSC increase in alarms/batteries to reflect increase in visits	0.45
Other	0.10
Updated 2007/08 – 2011/12 Programme31.6	32.65

34. The analysis above shows that the latest 5 year capital programme has increased in real terms by £1.10m.

35. **Kensington community fire station £0.55m** - Report CFO/169/07 (Authority meeting 13 September, 2007) agreed in principle to the proposal for the construction of a new fire station in Kensington to replace the one at Low Hill. The total cost of the scheme was estimated at £1.70m however £1.15m was to be met from deleting existing schemes (£1.0m from the PFI land scheme that was no longer required). The remaining £0.55m is to be funded from the sale of the Low Hill site, £0.25m, and a grant from Kensington New Deal for £0.30m.

36. **HFSC – increase in alarm/battery expenditure £0.45mFire Safety** – The success of the HFSC initiative has seen the number of home visits increase substantially over recent years and the knock-on impact of this has been a requirement to increase the provision for smoke alarms and batteries. The capital programme assumes 100,000 alarms (previous assumption was 90,000) will be fitted each year at an additional cost of £0.45m.

37. **Other issues NOT built into the updated 5 year programme, but officers wish to bring to members attention:**

HFSC – review policy on capitalising installation costs - The policy of capitalising installation costs was a short term measure to help balance the 2006/07 five year revenue medium term plan. The capital cost was funded by borrowing and a point would be reached when cumulative installation borrowing costs charged to revenue would be equal to or in excess of any net revenue savings from capitalising salary costs. The policy and approach on capitalising HFSC installation costs is being reviewed and will be reported in the closure of accounts. The £0.49m provision currently included in the 2008/09 - 2011/12 programme at a total cost of £1.97m, will be considered as part of this review.

Vehicles – Proposed price increases by Firebuy – The original capital programme planned to replace 23 water tender ladder vehicles during 2007/08 – 2011/12 23 at a cost of £4.00m. Based on Firebuy's latest purchase price an additional £0.74m is required to fund the purchase of these 23 vehicles. Firebuy have also informed the Authority that the cost of the 2 refurbished combined pump ladders has increased in total by £0.16m and the planned ancillary vehicles by £0.07m. In total the additional budget required to meet these vehicle price increases is £0.97m. The Assistant Chief Fire Officer will review the current plan and report back to members on this matter, until then **the capital programme assumes the vehicle replacement strategy can be delivered within the available budget**.

38. **Funding –** the overall cost of the current capital programme has increased in real terms by £1.10m, (paragraph 33.) and there have been some significant movements in the funding mix. The analysis below summarises the funding movements to date:

	£m
Original plus slippage funding package	**31.55**
Capital Receipts	
Take out Derby Road receipt	-1.00
Add proceeds from the sale of Low Hill FS	0.25
Grants	
Kensington New Deal	0.30
RCCO increase in contributions	0.07
Borrowing	
2007 CSR revised supported borrowing limits	0.85
Net adjustment to unsupported borrowing	0.63
Overall Increase in funding	32.65

Derby Road Capital Receipt £1.0m - MACC will remain in operation until at least the beginning of 2010 as the regional control room will not be operational before then. Also, as the service is considering the future operational use of the Derby Road building it has been deemed prudent to assume the building will be required for the foreseeable future and therefore take the forecast £1.0m capital receipt out of the funding provision for capital expenditure.

Low Hill Capital Receipt / Kensington New Deal Grant – Report CFO/169/07, Authority meeting 13 September, 2007, updated members on the proposals for a new fire station at Kensington at an estimated cost of £1.70m. The report identified £1.15m of existing available funds to contribute towards the scheme costs and additional monies from the anticipated capital receipt from the sale of the current Low Hill site, £0.25m, and a £0.30m grant from Kensington New Deal to cover the overall increase in expenditure.

RCCO – A number of small increases in scheme costs are being met by an increase in revenue contributions, £0.07m.

Borrowing – The latest comprehensive spending review 2007 (CSR07) announced the updated **supported borrowing** allocations for 2008/09 – 2010/11, £9.24m, an increase of £0.85m to the amount in the original programme. The unsupported borrowing is in essence the balancing funding figure and after accounting for the:

- £1.10m increase in the capital programme,
- the net reduction non borrowing funding of £0.38m,
- the increase in supported borrowing of £0.85m,

the required unsupported borrowing has increased by £0.63m from £9.93 to £10.56m.

Use of Reserves

39. During the period covered by this report the most significant movement in reserves was the use of £0.11m from the Modernisation Reserve to invest in the water rescue equipment (CFO/13/08). The general revenue balance remains at the level agreed in the original budget at £2.00m or 3% of the net revenue budget, a level deemed prudent and realistic based on the current Authority risks.

Summary

40. The effect of the variations to the revenue budget including approved amendments, proposed variations, pay, and general inflation have been allocated to the appropriate individual lines within the budget and details of all these can be found in Appendix A to B. Overall the current budget requirement remains at the same level approved in the original budget £69.595m. The Authority is on target to deliver in cash terms the cumulative £4.00m dynamic staff saving. The latest year-end forecast projects a small additional saving of £0.10m or 0.1%.

41. The 2007/08 capital programme requires £4.97m to be re-phased into the future years programme. Overall the total capital programme expenditure has increased by £1.10m to £32.65m. Within the programme some individual scheme lines have required significant cost movements and funding changes. Borrowing has increased by £1.48m (supported £0.85m & unsupported £0.63m), reflecting the loss of Derby Road £1.0m capital receipt and the increase in the capital programme not funded by external contributions.

42. The Authority's general reserve stands at £2.0m (3% of the net revenue budget) and is deemed prudent and realistic in comparison to the risks faced by the service.

(C) Treasury Management

43. The Authority continues to "buy in" Treasury Management from Liverpool City Council. The following paragraphs reflect Treasury Management activities in the period April to December 2007/08.

Prospects for Interest Rates

- Shorter-term interest rates

44. The UK's Monetary Policy Committee (MPC) was concerned about the risk that inflation which had reached 3.1% in March 2007 would not fall back as quickly as anticipated to its 2% target. Treasury Officers thought that the MPC would vote for at least one but probably two more rate hikes of 0.25% to achieve this. UK short term interest rates (bank rate) were therefore predicted to rise from 5.25% at the start of the financial year to 5.75% early in the year and then remain static for the rest of the financial year.

45. The domestic economic backdrop continued to present problems for the Monetary Policy Committee in the early months of the year. CPI inflation breached the 3% upper limit of the Government's target range in April, consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices. The Official Bank Rate was raised to 5.5% in May and 5.75% in July in response to the deteriorating inflation outlook. In addition, the Bank of England's May and August Inflation Reports hinted that more hikes might be necessary if the Government's target was to be met over the medium term.

46. The turbulence in financial markets since September placed upward pressure upon money market short term deposit rates. Those rates rose above 6% because of a lack of liquidity in the market. Effectively, the market delivered the increase in interest rates without action from the MPC. The uncertainties clouding the economic and monetary outlook have continued and it became clear that 5.75% was the peak in the current cycle. Bank Rate was maintained at 5.75% in November but reduced to 5.50% at the December MPC meeting and 5.25% at the February meeting in response to forecasts of a slowdown in the economy in the coming months.

- Longer-term interest rates

47. It was forecast that longer term rates would rise in the early part of the year due to continuing inflation concerns, buoyant growth and an expected higher Bank Rate. Thereafter, assuming growth and inflation moderate, it was expected that rates would return towards previous levels. Longer-term PWLB (Public Works Loans Board) rates were expected to rise from 4.40% at the start of the financial year to reach perhaps 4.75% in the middle part of the year before falling back to around 4.50% by the end of the year.

48. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into the New Year as concerns persisted about international inflation pressures. PWLB rates peaked in late June but eased back in the summer months as evidence of some deceleration in US economic activity lessened fears about future inflation prospects. At the end of September 2007 the PWLB 50 year rate stood at 4.75%. Since then, market turbulence has resulted in a volatile market but overall some reduction in long term rates to around 4.60%. Forecasts are for lower rates later in the financial year if the markets remain unstable.

Capital Borrowings and the Portfolio Strategy

49. The Authority's net capital borrowing requirement for 2007/08 was estimated at £12.8 million. The anticipation was that long-term fixed rates would remain lower than shorter term borrowing throughout 2007/08. New borrowings would therefore be at longer term rates in order to minimise borrowing costs. Against this background, the interest rate market is monitored and a pragmatic approach is adopted to any changing circumstances.

50. The following loans have been arranged from the PWLB.

	AMOUNT (£ million)	PERIOD (yrs)	RATE (%)
	3.0	46.0	4.85
	3.0	45.5	4.55
	2.0	29.5	4.48
	2.0	4.0	4.55
Total	10.0		

The total £10.0 million new loans are at an average rate of 4.63% for an average period of 34 years. This compares with the average 34 year offered rate in the first three quarters of the financial year 2007/08 of 4.74%. The first loan was arranged when cash balances were low and short term borrowing rates were over 5.80%. The second and third loans were arranged when rates were perceived to be at low points in the cycle.

Annual Investment Strategy

51. The investment strategy for 2007/08 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with CLG Guidance and CIPFA Code of Practice. Investments are made in sterling with an institution on the counterparty list and for a maximum of one-year duration.

52. The Authority aims to optimise investment returns whilst maintaining appropriate levels of security and liquidity. In the first three quarters of the financial year 2007/08 the average rate of return achieved on average principal available was 6.10%. This compares with an average seven day deposit (7 day libid) rate of 5.69%.

53. The Investment Strategy specifies that investments are only made with banks with a high credit rating. UK banks must have at least an A long term rating for inclusion on the Authority's counterparty list. Northern Rock met this criteria and the authority had an investment of £2 million which was repaid on 31 October. Nevertheless, no further investments will be placed with Northern Rock whilst any doubt exists over its financial standing. The market is closely monitored and other banks seen to have problems may be suspended from the list.

Debt Rescheduling

54. Rescheduling of debt is the early repayment of loans and replacement by loans for different periods and at different interest rates. It can be used to enhance the balance of the long term portfolio by for example amending the maturity profile or changing volatility levels and may on occasion generate cash savings. Debt rescheduling becomes more beneficial when the relationship between short and long term rates moves appreciably. The strategy for 2007/08 indicated that interest rate structures would be continually monitored in order to take advantage of any perceived anomalies in the yield curve.

55. Treasury Management has contributed to budget savings in recent years by debt rescheduling. In 2006/07 annual savings of around £60,000 and total savings of £800,000 were achieved. However, the ability of Treasury Management to continue to generate savings in future years has been constrained by 2 significant changes in market practice.

Firstly, the Statement of Recommended Practice (SORP) 2007 introduced changes to the way treasury management activity is accounted for. One effect is to dilute the benefits that may accrue from the generation of discounts by rescheduling because any discounts must now be spread over a longer period.

Secondly, changes to the terms of borrowing and repayment of PWLB loans were introduced on 1st November 2007. Interest rates are now quoted in much narrower bands making the differential between bands much narrower. The benefits of repayment and re-borrowing for similar periods are therefore reduced. In addition, the PWLB also introduced a new set of interest rates for repayment of loans at around 0.5% lower level than those for borrowing. This measure significantly limits any future debt rescheduling.

<u>External Debt Prudential Indicators</u>

56. The external debt indicators of prudence for 2007/08 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£64 million
Operational boundary for external debt:	£54 million

Against these limits, the maximum amount of debt reached at any time in the first three quarters of the financial year 2007/08 was £49 million.

<u>Treasury Management Prudential Indicators</u>

57. The treasury management indicators of prudence for 2007/08 required by the Prudential Code were set in the strategy as follows:

(a) Interest Rate Exposures

Upper limit on fixed interest rate exposures:	100%
Upper limit on variable interest rate exposures:	50%

The maximum that was reached in the first three quarters of the financial year 2007/08 was as follows:

Upper limit on fixed interest rate exposures:	100%
Upper limit on variable interest rate exposures:	0%

(b) Maturity Structure of Borrowing

Upper and lower limits for the maturity structure of borrowing were set and the maximum and minimum that was reached for each limit in the first three quarters of the financial year 2007/08 was as follows: -

Maturity Period	**Upper Limit**	**Lower Limit**	**Maximum**	**Minimum**
Under 12 months	30%	0%	6%	0%
12 months and within 24 months	30%	0%	6%	0%
24 months and within 5 years	30%	0%	4%	0%
5 years and within 10 years	30%	0%	5%	4%
10 years and above	95%	50%	90%	87%

(c) Total principal sums invested for periods longer than 364 days

The limit for investments of longer than 364 days was set at £2 million for 2007/08. No such investments have been placed during 2007/08.

(D) Internal Audit

58. During the third quarter of the year, Internal Audit submitted 1 report on Payroll, attached as Appendix D. The report made eight recommendations and although none of the issues identified by Audit were deemed to be essential or strategic matters officers have now actioned the necessary changes to remove any potential risks associated with the findings. Audit has drafted reports on the creditors and income systems and officers are currently reviewing the findings and finalising the reports with Audit. The attached Appendix E outlines 2007/08 audit work undertaken in up to December, and planned work for the remaining year.

(E) Monitoring of Financial Progress

59. In order to ensure that the internal financial processes of the Authority are operating effectively, for example payroll, debt collection and payment of invoices, a suite of performance indicators has been developed and now feed into the financial review. Appropriate performance indicators and the data collection processes for these indicators continue to evolve and their number will grow in future reviews. At present indicators relate to Payment of Invoices, Non-Payroll Expenses, Petty Cash, Order Processing and Debtors.

Prompt Payment of Invoices

60. Prompt payment of invoices is an indicator under the Best Value legislation and the Authority is required to measure the number of undisputed invoices paid within 30 days of receipt. In January 2007 the Authority reconfirmed its commitment to the Department of Trade and Industry's Better Payment Practice Code (BPPC), which gives notice to suppliers of the Authority's commitment to pay promptly. Considerable effort has been made to develop a range of administrative processes to enable the Authority to comply with its obligations under the BPPC.

61. A comparison of third quarter performance over previous years confirms that system improvements continue to enable the Authority to pay invoices (some 1450 per month) more promptly.

2003/04	100.00%
2004/05	99.9%
2005/06	97.9%
2006/07	99.7%
2007/08	99.8%

62. The target for prompt payment set by central government for 2007/08 is 100%. The third quarter's results reconfirm the Fire & Rescue Service continues to respond quickly and efficiently to requests for payment from suppliers, with 13,183 out of 13,209 invoices being paid within the timeframe.

63. In 2002 the Authority commenced making payments to suppliers by BACS transfer. The system was extended to pay non-payroll employee expenses and pension commutations. This initiative is consistent with the objective to, where possible, conduct business electronically in compliance with government targets. Previously all payments were made by cheque. In the period since April 2007 some 95% of invoice payments and 100% of employee payments been made electronically.

64. This represents a significant system improvement and enables the Authority to respond to a preferred payment method by both its suppliers and employees.

Processing Purchase Orders & Sales Invoices

65. Performance indicators have also been developed to monitor the turnaround of purchase orders, employee expense claims, petty cash reimbursements, sales invoices and late payment reminders. The purpose of these indicators is to give focus to quality service provision by helping to identify system weaknesses where they exist so that they can then be rectified.

66. The agreed turnaround targets are:

Purchase orders, 100% in 1 working day
Petty cash reimbursements, 100% in 2 working days
Sales invoice production, 100% in 2 working days
Reminder letters, 100% in 3 working days
Expense claims, 100% in 1 working day

67. Performance against these targets for equivalent quarter each year is as follows: (Cumulative)

	2003/4	2004/5	2005/6	2006/7	2007/8
Purchase Orders	99%	98%	98%	94%	100%
Petty cash reimbursements	89%	97%	100%	96%	100%
Sales Invoice Production	91%	94%	79%	86%	90%
Reminders	89%	92%	91%	86%	84%
Expense payments	100%	100%	99%	100%	100%

68. The targets have proved extremely demanding in the drive for quality service provision. However, those transactions that fail to meet the 1, 2 or 3-day turnaround target are invariably processed within two days of the required date. Significant improvements have been made within the administrative processes and this can be seen from the consistently high performance over the five-year period.

Debtors Process

69. A number of Performance Indicators have been developed to give drive and focus to the improvements to the debtor's process. In addition to the prompt turnaround of sales invoices and prompt turnaround of reminder letter performance indicators, referred to above, a further indicator has been developed to plot the age profile of outstanding debt.

70. Significant improvements have been made to the debt initiation and recovery processes so that services provided by the Authority are invoiced in a timely manner and pursued with increasing effectiveness, which increases the likelihood of prompt payment.

The Age Profile of Outstanding Debt

71. A comparison of the number and value of aged debts over 60 days for the first quarter can be summarised as follows:

Number of debts 60 days+

	2003/4	2004/5	2005/6	2006/7	2007/8
October	83	47	80	69	113
November	74	47	82	56	84
December	68	47	116	68	80

Value of debts 60 days+

	2003/4 £'000	2004/5 £'000	2005/6 £'000	2006/7 £'000	2007/8 £'000
October	63	102	141	129	207
November	60	124	127	97	191
December	63	31	382	127	346

72. The service raises approximately 1,200 debtor invoices per year and this can equate to income of between £2m - £3.5m. The profile of accounts raised varies significantly month by month and from year to year. It therefore can lead to potential "large" variations when comparing the same month over a three year period. The number of invoices over 60+ days fluctuates between 5% and 9% of the total raised in a 12 month period. The Authority's debt recovery process commences 30 days after a debt has been raised and the number of write offs anticipated each year is small. Up to and including this financial review report only 31 debtor accounts have been written off at a net cost of £18k. The increase in the value of debt in 2007/08 is attributable to two debtor accounts for the same organisation and the Authority faces little or no risk of non payment and it is anticipated the accounts will be settled before the year-end.

Bad Debts

73. The Executive Director of Resources has delegated powers to write off bad debts less than £5,000 but is required to report back when this power has been used. Appendix F analyses the proposed debt write off for this period on the basis the debts are deemed irrecoverable. The net value of the 15 invoices being written off is £12,643 and can be contained within the provision for bad debts.

(F) New Finance & Payroll Systems (FMIS)

74. The Authority's Payroll and new financial systems continue to operate effectively and in line with expectations and all payments were made without interruption.

75. The first half of the year saw the completion of a programme of training for Phase 1 of the rollout of e-procurement so that now more than 200 Users (predominantly those based in Service Headquarters) have access to the system and are using it to process their procurement requests. Given the extent of the change, there have been comparatively few issues to resolve as the systems "bed-in" and Users become increasingly familiar with new systems of work. The systems are operating as anticipated with Users acknowledging the business benefits that have been derived from the implementation of those systems.

76. A review has been undertaken by the Purchasing Operations Manager and the FMIS Manager of the e-Catalogue that sits within e-Procurement to ensure in includes all appropriate products in relation to Clothing/Uniforms, Operational Equipment and Breathing Apparatus. These will significantly enhance the effectiveness of the system when it is rolled out to Community Fire Stations. In support of that effort, the Stores Manager has provided photographic images of products that will be embedded within the e-Catalogue.

77. It is anticipated that e-Procurement will evolve over time as Users become familiar with the system and suggest "better ways of doing things". This learning culture and a willingness to be responsive to User requirements have already resulted in a number of changes being made to the e-Procurement software. To this end, the FMIS Project Team is working closely with CedarOpenAccounts' Development Team to drive forward enhancements to the e-Procurement application for the benefit of both parties.

78. The delivery of a second phase of developments to the e-Procurement software Phase 2 will include all Community Fire Stations and MACC. Whilst the timing of this Phase of the rollout is dependant on receipt of fixes to the new build of the e-Procurement application, detailed arrangements have been agreed with the Training & Development Academy for their Officers to commence training for Station-based staff in early February with a planned completion date of 31st March. It may be necessary to deliver "mop-up" sessions for those staff that require training beyond 31st March but it is anticipated that all Users will have access to the system by the end of April.

Equality & Diversity Implications

79. There are no equal opportunity implications in this report.

Financial Implications

80. See Executive Summary.

BACKGROUND PAPERS

Report CFO/46/07 “MFCDA Budget and Financial Plan 2007/2008-2011/2012” Authority 22 February 2007.

Report CFO/123/07 “Revenue Outturn 2006-2007 & The Statement of Accounts” Authority 26 June 2007.

Report CFO/153/07 “Financial Review 2007/08 April –June Review” Performance & Audit Management Committee 06 September 2007.

Report CFO/200/07 “Financial Review 2007/08 July - September Review” Performance & Audit Management Committee 08 November 2007.