AGENDA ITEM:

REPORT TO:	**MERSEYSIDE FIRE & RESCUE AUTHORITY BUDGET COMMITTEE**
DATE:	**26TH FEBRUARY 2009**
REPORT NO.	**CFO/020/09**
REPORTING OFFICER:	**EXECUTIVE DIRECTOR OF RESOURCES**
CONTACT OFFICER:	**KIERAN TIMMINS, EXECUTIVE DIRECTOR OF RESOURCES, EXTN. 4108**
OFFICERS CONSULTED:	**CORPORATE LEADERSHIP TEAM**
SUBJECT:	**FINANCIAL REVIEW 2008/09 – APRIL TO DECEMBER REVIEW**

APPENDIX	**A1**	**TITLE**	**REVENUE BUDGET MOVEMENTS SUMMARY**
APPENDIX	**A2**		**BUDGET MOVEMENT ON RESERVES 2008/09**
APPENDIX	**A3**		**FIRE SERVICE REVENUE BUDGET MOVEMENTS SUMMARY**
APPENDIX	**A4**		**CORPORATE SERVICE REVENUE BUDGET MOVEMENTS SUMMARY**
APPENDIX	**B**		**CAPITAL PROGRAMME 2008/09**
APPENDIX	**C**		**UPDATED 2007/08 – 2012/2012 CAPITAL PROGRAMME**
APPENDIX	**D**		**INTERNAL AUDIT PROGRESS REPORT**
APPENDIX	**E1,E2,E3**		**INTERNAL AUDIT REPORTS ISSUED SINCE LAST FINANCIAL REVIEW**
APPENDIX	**F**		**WRITE-OFFS APPROVED SINCE THE LAST FINANCIAL REVIEW**

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*** A Glossary of Terms has been provided at the end of this report for your reference.**

<u>Purpose of Report</u>

1. To review the financial position, both revenue and capital, for the Authority for 2008/09. 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/244/08 and covers the period up to December 2008.

Recommendation

2. It is recommended that Members approve:

   2.1 The 2008/09 revenue and capital programme budget variations identified in this report, (outlined in Appendix A to C); and

   2.2 Instruct the Executive Director of Resources to work with budget holders to maximise savings in 2008/09.

Executive Summary

Revenue:

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

- To deliver the required savings through staffing efficiencies, which will be achieved without redundancy by using natural retirement rates and if required VER/VS.

- Continue with its modernisation programme and deliver the Authority's vision of making Merseyside a Safer, Stronger, Healthier Community.

Members will recall that at the start of this year the Authority's outstanding dynamic staff saving target for 2008/09 was £2.594m,(rising to £3.897m by 2010/11). Staff savings approved up to the last financial review of £0.661m and a further £0.296m identified in this report have reduced the outstanding target to £1.637m for 2008/09 at the time of writing this report.

The report identifies that in cash terms the retirement rate for this year means that the Authority is slightly behind schedule in delivering this saving in 2008/09. The full year impact of those retiring this year is expected to return the Authority to be on track (in cash terms) with its financial plan in 2009/10.

To deliver the required savings on a permanent basis over the long term, the service must implement the structural efficiencies to revise the approved establishment to the affordable level built into the approved financial plan. To that end the Authority is on target to deliver the structural changes in its workforce to maintain savings in the longer term but some work remains outstanding to deliver the full remaining savings target of £2.918m by 2010/11.

However, this target will increase for any pay award in excess of the anticipated 2% in the current five year financial plan. Each additional 0.1% equates to a permanent and accumulative increase in the staff savings target of approximately +£0.050m. In 2008/09 the agreed 2.45% firefighter and proposed 2.45% local government workers pay offer will increase the required saving target by £0.250m in a full year. Also, any changes to the 2008/09 – 2012/13 financial plan, considered in the 2009/10 – 2013/14 Budget and Financial Plan report CFO/021/09 will also impact on the required overall saving target.

Overall changes on the revenue budget (including shortfall on the dynamic staff savings target) identify an adverse variance on the budget of £0.830m. Officers are working to control non staff budget lines with a view to identifying offsetting savings that maintain a broadly neutral position. This will be reported in detail in the final accounts.

Capital:

The report identifies a small number of significant changes to the current 5 year capital programme and a net increase of £5.600m – mainly due to:-

- The project to relocate workshops and create an engineering centre of excellence;
- An increase in fire appliance prices;
- A review of the capitalisation policy on smoke alarms.

A significant increase in specific funding (capital grant) has lead to an overall reduction in the borrowing requirement of £2.358m. Details of the changes to the capital programme are outlined in Appendix B & C.

Reserves & Balances:

The general balance remains unchanged at £2.0m (3% of net budget). Appendix A2 outlines the movements on earmarked reserves of £0.898m since the last financial review report.

Treasury Management:

Short-term interest rates - it is now evident that the predicted economic slowdown is likely to be more severe than forecast and the Bank Rate is has now fallen significantly to 1.5%. Longer term - 3 loans with a total value of £3.5 million at an average interest rate of 4.21% for an average period of 3 years have been arranged from the PWLB. All borrowings are in line with the Treasury Management Strategy and the prudential indicators set by the Authority.

The overall economic volatility and movements in inflation and interest rates are being monitored closely. The unprecedented events in the year described in the report have resulted in a change of strategy. Now, any new borrowing will be for short periods or at short term variable rates. Short term rates are now below long term rates and are likely to remain so for some time. In this scenario, it is better to reduce investments and borrow for short periods and possibly at variable rates when required.

Financial Processes:

Performance in Financial processes remains strong.

Introduction & Background

Structure of Report

3. This report is the review of the Authority's position up to the end of the December of the financial year 2008/09 (April – December 2008).

4. 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

(A) Current Financial Year – 2008/09

5. 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, if necessary, identifies appropriate corrective action.

Revenue Budget

6. The attached Appendix A1 to A4 summarises the revenue budget changes since the last financial review report. The changes reflect the issues discussed in detail further on in this report but can be summarised as:

   (a) Dynamic staff saving – a reduction in the unallocated dynamic staff saving target and employees budget of £0.300m as a result of implementation of Belle Vale LLAR.

   (b) Changes in the use of earmarked reserves of £0.898m to fund approved increases in the budget. The most significant was the decision of the Authority to approve the project to develop an engineering centre of excellence. Members will recall this scheme was partially funded by a contribution from reserves of £0.640m. In addition PFI expenditure was funded from reserves. This was a timing issue on project payments fully reported to the Authority in CFO/003/09.

(c) Allocation of the inflation provision of c£0.350m to fund the assumed green book staff pay award of £2.45% in 2008/09 only.

(d) Other small virements between service accounts have been approved in line with powers delegated to officers that net to a nil overall budget movement.

(e) The budget has been adjusted to reflect the “income” from the recharge to capital of salary costs associated with the installation of the HFSC alarms, (£1.000m). This credit is offset by the need to fund this charge to capital from the revenue budget.

7. The net budget remains at £71.201m.

Revenue Forecast Position

8. The following paragraphs outline those areas considered to be at risk of possible significant variation to the current budget.

<u>Employee Costs</u>

9. As total employee costs make-up over 80% of the Authority’s revenue budget this is the most risk critical area in terms of financial management and therefore monitored extremely closely.

10. 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 that aimed to reduce employee costs by £7.573m between 2006/07 – 2010/2011. (The original target of £5.200m because of previous funding changes was increased by £2.373m because of poor grant increases in the period 2008 – 2011) The accumulated dynamic staff saving target for the end of 2008/09 is £6.288m, of which £1.637m remains to be delivered at the time of writing this report. This savings target was based upon the estimated maximum achievable savings by utilising natural retirement rates over the 2006/07 to 2010/11 period.

Uniform retirements have continued at a high level but are slightly behind original expectations. Expected uniform staff budget savings are forecast to be £0.900m

Because of timing differences between when staff leave the organisation and the Authority agrees changes to the establishment, officers manage staff levels dynamically to maintain service levels to Merseyside. To do this, they use a variety of “tools” including the use of pre-planned overtime where appropriate and the payment of additional responsibility allowances. Up to £0.550m additional expenditure is anticipated in this area this year (1.2% of total uniform salaries).

The Authority meeting on 27 November 2008, ratified the decision of the Consultation and Negotiation Panel that attendance or discipline sanctions awarded prior to 1st January 2009 should not disqualify individuals from the payment of CPD allowances. Following on from this change in eligibility for CPD allowances an estimated £0.145m of 2007/08 CPD payments has now been paid out in 2008/09. The cost associated with these 2007/08 related payments has been met from the current uniform employee budget resulting in a reduction in the overall cash saving available to cover the outstanding dynamic staff saving target.

The Authority's status 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 significant increases in the level of secondment income over recent years, in 2007/08 income was approximately £0.687m. The current budgeted secondment income in 2008/09 is £0.261m and officers are confident the actual income for the year will exceed this by approximately £0.350m.

The non-uniform establishment budget is based on a fully staffed service with all staff at the top of their grade. Based on December actuals, officers forecast a saving on non-uniform budgets due to vacancies and incremental savings of approximately £0.350m.

Overall as a result of all these variations the Authority is expected to deliver its dynamic staff savings target by 2010/11.

<u>Revenue Costs Associated With Capital and Investment Income</u>

11. As a result of the forecast re-phasing of £4.754m of capital schemes from 2008/09 to 2009/10 identified in the previous financial review report, (mainly due to £2.4m for fire station & building re-phasing now due to be finalised next year, and £1.9m for delays in vehicle delivery), and a further £1.693m in this report (see paragraph 24), the amount set aside from revenue towards the repayment of loan debt (MRP) is forecast to be approximately £0.050m less than anticipated as borrowing is therefore not required until later dates.

12. Despite the recent fall in interest rates the latest forecast of anticipated investment income for the year indicates a potential £0.350m favourable variance. The main reason for the increase stems from the investment of funds received in advance of expenditure such as the firefighter pension grant and loans taken out to fund delayed capital expenditure. These investment funds benefited from interest rates that were high earlier in the year (see Treasury Management – Annual Investment Strategy section of this report).

13. The following items were reported in the last financial review and there has been no change in the anticipated year-end position.

ICT Saving Target

14. The original budget anticipated £0.426m of efficiency saving on ICT expenditure in 2008/09 and future years. One of the main areas expected to contribute to this saving was the reduction in ICT costs following the ICT support re-tendering process. The ICT re-tendering exercise was expected to be completed late in 2008/09, however, this is now not likely to be completed until March 2009. Whilst we work closely with our current partner, Telent, to deliver savings, it now seems likely that this target will not be met in full, and that £0.2m of the required saving will not be delivered until 2009/10.

Inshore Rescue Service

15. Inshore Rescue Service – following negotiations with partners around planned phased reductions in original partners contributions to this service and a shortfall in the expected fees and charges, this service is facing a potential adverse variance of £0.100m in 2008/09.

Contingency for Pay & Price Increase

16. The 2008/09 firefighter pay award is 2.45% (with effect from 1st July 2008), 0.45% above the 2% assumed in the financial plan. The impact of this additional 0.45% will result in a permanent increased savings target of £0.150m (£0.200m in a full year). Members will recall that during the budget making process it was agreed that any inflation requirement above that assumed and provided for in the approved financial plan would have to be met from an increase in the efficiency saving target. The additional 0.45% firefighter and the proposed 2.45% non-uniform pay award (yet to be formally accepted) will increase the dynamic staff saving target by £0.250m in a full year. Officers are working to see if the impact of the higher than anticipated pay award can be contained in the overall budget in 2008/09.

Summary of Forecast Position

17. The overall impact of the variations has resulted in a revenue forecast position with a potential £0.830m adverse variance. As Members would expect the Chief Fire Officer ensures officers monitor all budgets to guarantee they are managed closely. It is anticipated that this close management will identify offsetting savings. The position can be summarised in the table below:

Table A

Revenue Position Based on Actuals to 31/12/08		
	£m	£m
Employee Costs		
Inflation Provision - additional 0.45% pay	0.20	
Outstanding Dynamic Saving in 2008/09	1.64	
Uniform direct salaries saving	-0.90	
Dynamic Staffing Costs	0.55	
2007/08 retrospective CPD payments	0.14	
Non-Uniform forecast savings	-0.35	
Income - Secondment Income - increase in anticipated income	-0.35	
Net Shortfall in Dynamic Staff Saving Target		0.93
Revenue Costs associated with capital / Interest earned on investments		-0.40
ICT Saving target -unlikely to deliver full saving this year		0.20
Inshore Rescue Service Income		0.10
Anticipated budget management efficiences		-0.83
Forecast Outturn		0.00

If the savings target for efficiencies identified above is not achieved the Authority will need to review its strategy on reserves and alternative financing mechanisms for funding capital expenditure not funded through borrowing.

18. In order to delivery the required saving on a sustainable long term basis the organisation must implement structural efficiencies that match the establishment to the actual numbers of people. The Authority has made a large number of efficiency changes which have been delivered since 2006/07 these include:-

(a) LLAR stations
(b) CFS Restructure
(c) Senior Officer Review
(d) Retained Appliances.

19. However, 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. Members will recognise that the Fire Brigades Union (FBU) continue to dispute some changes already agreed.

Other Potential Issues

Home Fire Safety Checks, (HFSC)

Performance on the HFSC programme has continued to be outstanding and the number of visits anticipated in 2008/09 is over 100,000. The Authority have in the past capitalised the alarm installation costs associated with HFSC and funded these capitalised salary costs through borrowing. However, the policy has been reviewed in the light of changing legislation as the Government has introduced amendments to the capital regulations regarding the determination of the prudential MRP (the minimum amount to repay debt) and it is now recommended over the long term to finance this capitalised cost through a revenue contribution to capital, (£1m of capitalised salaries funded through unsupported borrowing is likely to result in a £1.6m debt repayment & interest charge to revenue over a 10year period). Therefore the current capital programme has assumed capitalised HFSC salaries are to be funded by the revenue saving following the capitalisation of HFSC salaries.

World Firefighter Games 2008

20. The World Firefighter Games 2008 delivered one of the best, if not the best, games ever held. Officers at the time of writing this report are finalising the final accounts position but the Authority's commitment is anticipated to remain at the approved funding of £0.300m

Private Finance Initiative (PFI)

21. The contribution required from the Authority remains consistent with the amount assumed in the financial plan and financial models.

Capital Forecast Position

22. The approved and proposed changes to the capital programme since the last financial review are set out in Table B below and will increase the 5 year programme by £5.600m. However as the available specific funding has increased by £7.958m, the Authority's borrowing requirement will actually reduce by £2.358m. The changes proposed to the capital programme are summarised below:

Table B: Movement in Capital Programme Since the last Financial Review:

Summary of Movement in 5 year Capital Programme to Qtr 2:

Expenditure / Funding Changes	Total Cost £	2008/09 £	2009/10 £	2010/11 £	2011/12 £	2012/13 £
EXPENDITURE:						
Re-phasing based on latest information	0	-1,693,000	1,193,000	-500,000	500,000	500,000
New & Increase in Schemes						
Workshop centre of excellence	3,165,000	2,314,000	851,000			
HFSC reflect installation of 100,000 alarms	2,535,000	507000	507,000	507000	507000	507,000
Revised provision for Station fridge/freezer	129,000	0	21,000	36000	36000	36,000
Adjust vehicle programme for latest replacement costs	7,500		3000	-3500	-6000	14,000
ReflectFirebuy increase in price for Fire Engines	1,000,000		500,000	250,000	250,000	
Increase in scheme cost funded from revenue	40,500	40,500				
Reduction/deletion in schemes						
Revision of RCCO for Toxteth Fire Station	-250,000		-250000			
ICT Licences	-832,000		-208,000	-208,000	-208,000	-208,000
Old workshop roof is not required	-175,000	-175,000				
Reduction in Allerton LLAR Accom scheme costs	-20,000		-20,000			
Overall Expend change qtr 2 to 3:	**5,600,000**	**993,500**	**2,597,000**	**81,500**	**1,079,000**	**849,000**
FUNDING						
Capital Receipts						
Anticipated Sale of old workshop	650,000		650,000			
Revision of RCCO for Toxteth Fire Station	-250,000	-250,000	0			
External Contributions						
Fire World contributions re-phase	0		-3,060,000	-2,975,000	3,060,000	2,975,000
R.C.C.O. (revenue contribution to capital)						
HFSC capitalised installation costs funded by RCCO	5,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Workshop centre of excellence - Cap Investment Reserve	640,000	640,000				
FMIS project RCCO from Finance service	30,000	30,000				
Vehicle equipment funded from Transport service	3,000	3,000				
Increase Deaf alarms funded from Community Safety	7,500	7,500				
CSR07 new Capital Grant	1,877,317		805,328	1,071,989		
Net impact to borrowing requirement	-2,357,817	-437,000	3,201,672	984,511	-2,981,000	-3,126,000
Overall Funding change qtr 2 to 3:	**5,600,000**	**993,500**	**2,597,000**	**81,500**	**1,079,000**	**849,000**

23. Appendix B (change to the 2008/09 programme) and Appendix C (the updated 2008/09 – 2012/13 programme), provide Members with more details of the proposed amended programme. The main areas of change are as follows:

<u>(a) Re-phasing</u>

24. Re-phasing of £1.693m from 2008/09 into future years has been identified.

- **Building & Land** programme - £1.268m for station refurbishment or building work that due to the time required to draw up and approve plans, go out to tender and agree legal arrangements is now expected to be incurred in 2009/10.

- **ICT programme -** £0.797m for re-phasing major ICT projects such as the Authority's document management system or incident ground management system. Due to the complexity and ever changing technology available these projects require substantial research and evaluation of alternative options in order to identify the best solution for the Authority. While significant progress has been made to date in planning for these schemes the costs associated with implementing these projects are now expected to fall in 2009/10.

- **Vehicles programme** -the quarter 2 review report identified £1.622m of re-phasing for planned spend on fire engines from 2008/09 into 2009/10. However since that report officers had an opportunity to guarantee the purchase of eight fire appliance chassis's this year and £0.687m has now been rescheduled from 2009/10 back into 2008/09.

- **FireWorld project**, the amended 5 year programme assumes the scheme will not commence in 2009/10 and re-phased the project to 2011/12.

(b) New Additions

25. Table B indicates an overall agreed net increase in the capital programme of £5.600m and an increase in specific non-borrowing funding of £7.958m:

Engineering Centre

26. The Authority has agreed the proposals for a new engineering centre for excellence. The revised capital programme now includes a provision for £3.165m to deliver the project, funded from £1.290m of specific funding (capital reserve £0.640m and an anticipated capital receipt £0.650m) and the balance from borrowing.

Home Fire Safety Checks

27. The community fire safety capital programme has been increased to reflect the increased installation costs associated with the successful HFSC programme now expected to install approximately 100,000 smoke alarms each year. As previously reported this requires an additional £0.507m per annum in the programme or £2.535m over the 2008/09 – 2012/13 period. As mentioned early in this report the assumption is that all capitalised installation costs will be funded by a revenue contribution to capital spend, (previously funded via borrowing), this has increased specific funding by £5.000m and reducing required borrowing by £2.465m (previously based on 50,000 alarms p.a. being installed).

Vehicles

28. Members considered report CFO/99/08 at the Authority meeting 19 May, 2008, to determine what action to take in light of the 20% increase in fire engine prices purchased under the Firebuy national framework contract. The report indicated that the revised vehicle prices would require an increase in the current vehicle capital budget of £1.000m. While Members noted officers are currently considering alternative options for vehicle procurement they supported an increase in the capital budget to reflect the increase in prices.

(c) Programme Reductions

ICT Licences

29. Within the ICT programme was an annual provision for the cost of the Microsoft agreement (HOMA). This agreement allowed the Authority to upgrade its Microsoft systems for any developments made by the firm in respect of the licensed applications. The agreement comes to an end this year and rather than renew the agreement at a cost of c£0.208m a year, (£0.832m over 2009/10 - 2012/13), officers will monitor future Microsoft developments. If at some future point in time officers consider further development in Microsoft applications is required they will report back to Members and seek funding for the required investment.

(d) Change to Available Funding (not covered in (b) & (c)

Capital Grant

30. Members will recall that the CSR07 announced fire authorities would receive a grant towards the cost of capital investments in 2010/11 – 2011/12. On the 15 December 2009 CLG announced the Authority would receive a capital grant of £0.805m and £1.072m in 2009/10 and 2010/11. As the Authority already has an approved 5 year programme covering the period associated with this grant it has been assumed that the Authority is mindful to reduce the level of borrowing originally anticipated for this period in the programme.

Summary

31. In summary the overall programme has increased by £5.600m but due to the availability of specific funding in the form of revenue contributions, capital receipts, use of reserves and the new capital grant the overall borrowing requirement has reduced from £27.941m (quarter 2 review) to £25.583m, or -£2.358m.

Annual Minimum Revenue Provision (MRP) Statement:

32. The Authority is required under the new Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 to prepare a statement on its policy for MRP in respect of the forthcoming year.

33. The new regulations were only finalised on 28 February 2008 and allow the MRP statement in respect to years 2007/08 and 2008/09 to be approved during the financial year 2008/09. The new regulations require authorities to pay debt at a rate which it considers prudent. The new regulations guidance interprets MRP may be deemed to be prudent if it is either:

- Based over a period that is reasonably commensurate with that over which the capital expenditure / asset provides benefits (asset life); or

- For the element of expenditure met from borrowing supported by government Revenue Support Grant (RSG), a period reasonably commensurate with the period in the determination of that grant (this in reality would equate to the current 4% MRP methodology)

The regulations set out four options for calculating MRP and officers will outline in the 2009/10 – 2013/14 budget and financial plan the proposed MRP policy for 2009/10 and future years, and re-affirm the position for 2008/09.

<u>Current MRP policy for 2008/09</u>

34. The 2008/09 – 2012/13 financial plan in anticipation of the new regulations assumed for 2007/08 and 2008/09 no change would be made to the Authority's current policy on MRP. The current policy is based on the regulatory method of calculating MRP which is based on 4% of the capital financing requirement (CFR) which is an amount broadly equivalent to the Authority's outstanding debt. The new regulations do allow the Authority to continue applying the regulatory method to all borrowing in 2008/09 both that supported by the RSG and that unsupported (but deemed affordable under the prudential regime). However, from 2009/10 only supported borrowing can have MRP based on this method. This matter will be covered in the 2009/10 budget report.

Use of Reserves

35. The analysis in Appendix A2 outlines a £0.898m movement on reserves during the third quarter of 2008/09. The most significant drawdown is from the capital investment / PFI reserve of £0.787m, of which £0.640 relates to the approved funding for the new capital scheme for the accommodation / workshop initiative, and £0.147k for the continued support for the PFI project. The balance of £0.111m is required to fund costs associated with projects and grant funded schemes for which funding was received in 2007/08 and carried forward into 2008/09 in the form of an earmarked reserve. The general reserve has remained unchanged at £2.000m.

36. The position on all reserves is set out in Appendix A2

Summary

37. Overall the current budget requirement remains at the same level approved in the original budget £71.201m.

38. Due to a slight timing issue the delivery in cash terms of the outstanding dynamic staff saving for 2008/09 may not be achievable. However the plan remains on target for the overall saving requirement contained in the 2008/09 – 2012/13 original financial plan to be met by 2010/11. 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. It is not unreasonable to anticipate that this action by management will deliver a significant contribution towards the £0.830m potential shortfall.

39. The 2008/09 – 2012/13 capital programme has been increased by £5.600m to provide funds for the:

- approved accommodation & workshop initiative, £3.165m;
- increased installation costs resulting from the successful HFSC visits rising to 100,000 p.a, £2.535m; and
- to offset the increase in price of +20% in fire engines facilitated through the Firebuy contract, £1.000m.

The deletion of some schemes no longer required such as the old workshop roof, and the Microsoft HOMA agreement has kept the overall increase to £5.600m. The increase in specific capital funds of £7.958m has resulted in an overall reduction in the borrowing requirement of £2.358m. The biggest increase in specific capital funding has been the decision to fund the HFSC installation costs from revenue (funded from the salary budget for the capitalised salaries), £5.000m, and the use of the new capital grant of £1.877m announced by the Government.

40. The Authority's general reserve stands at £2.000m (3% of the net revenue budget) and is deemed prudent and realistic in comparison to the risks faced by the service. Earmarked reserves of £0.898m have been drawndown so far this year to fund costs associated with approved projects and grant funded schemes.

(C) Treasury Management

41. 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 2008/09.

42. Treasury Management processes are designed to manage treasury management risks particularly with regard to liquidity, interest rates and the security of investments. The Authority's Treasury Management Practices indicate that "the Treasury Manager remains alert for any financial disturbance or world event that may trigger extraordinary action that may need to be taken". The global financial crisis was closely monitored for impacts on interest rates, borrowing and investments and action taken is shown below.

Prospects For Interest Rates

Shorter-term interest rates

43. The strategy statement for 2008/09 noted that the slowdown in economic activity caused by significant tightening of credit conditions would put downward pressure on inflation and hence provide scope for further cuts in official interest rates. UK bank rate was predicted to fall to 4.75% by the end of the financial year.

44. As expected, the Monetary Policy Committee (MPC) cut the Bank Rate from 5.25% to 5.00% at its April meeting. In the following months, inflation was the more dominant concern for the MPC and the rate was held at 5.00% until October. The extreme volatility of the world's financial markets, concerns over the effectiveness of financial rescue packages and the dangers of deep and prolonged recessions resulted in a change of approach from the MPC.

45. It became evident that the predicted economic slowdown would be much more severe than forecast and an emergency cut of 0.5% in Bank Rate was announced by the MPC on 8th October as part of co-ordinated action by central banks around the world. This was followed by unprecedented cuts of 1.5% at the November MPC meeting, 1.00% at the December meeting and a further 0.5% at the January 2009 meeting which brought bank rate down to 1.50%, its lowest level since the 1950s. The MPC is expected to continue to ease policy and a Bank Rate of 1.00% is a distinct possibility.

Longer-term interest rates

46. It was forecast that concerns over the health of the financial markets would initially keep longer term rates flat but uncertainty over inflation prospects would ultimately drive rates higher. Longer-term Public Works Loans Board (PWLB) rates were expected to rise to perhaps 4.75% by the end of the year.

47. The PWLB 50 year rate rose slightly from below 4.50% to above 4.75% in October. There was considerable volatility in the money markets and this rate rose and fell on a daily basis but with a downward tendency in response to financial instability in the market. It fell to below 4.00% in early December.

48. Long-term interest rates will be the victim of conflicting forces. The threat of deep global recession should exert downward pressure but the prospect of exceptionally heavy Government borrowing in the coming years could severely limit the downside potential.

49. The relative movements in short and long term rates marks a significant turning point in the structure of interest rates. For many years there has been what is known as an inverted yield curve i.e. short term rates have been higher than long term rates. In this scenario it was beneficial to borrow long and invest short term. Short term rates are now below long term rates (a normal yield curve) and are likely to remain so for some time. In this scenario, it is better to reduce investments and borrow for short periods and possibly at variable rates when required.

Capital Borrowings and the Portfolio Strategy

50. The Authority's net capital borrowing requirement for 2008/09 was estimated at £5.8 million. The strategy for 2008/09 is to move towards a more balanced maturity profile by arranging new borrowings for periods up to 10 years when these rates are comparable with longer term rates. Against this background, the interest rate market is monitored and a pragmatic approach is adopted to any changing circumstances.

51. In accordance with the original strategy, 3 loans with a total value of £3.5 million at an average interest rate of 4.21% for an average period of 3 years were arranged from the PWLB. The average 3 year PWLB offered rate in the period April to December 2008/09 was 4.20%.

52. The unprecedented events later in the year described above have resulted in a change of strategy. Now, any new borrowing will be for short periods or at short term variable rates.

Annual Investment Strategy:

53. The investment strategy for 2008/09 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with government guidance and the CIPFA Code of Practice. Investments are made in sterling with an institution on the Authority’s approved counterparty list and for a maximum of one year duration. The Authority aims to optimise investment returns whilst maintaining appropriate levels of security and liquidity. The average rate of return achieved on average principal available in the period up to December 2008/09 was 5.88%. This compares with an average seven day deposit (7 day libid) rate of 4.44%.

54. 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. The money markets are continually monitored for information regarding the creditworthiness of financial institutions and notifications are received of any changes to credit ratings made by any of the rating agencies. An institution is immediately suspended from the Authority’s list of institutions should any doubt arise about its financial standing regardless of whether its credit rating is downgraded.

55. Northern Rock, Bradford & Bingley and Alliance & Leicester banks were suspended during 2007/08. The two Icelandic banks based in the UK were suspended in April 2008. The other Icelandic banks were never included on the counterparty list because they did not have the higher credit ratings required for foreign banks under the investment strategy. Irish banks were also suspended until clarification of their creditworthiness was obtained.

56. In response to the uncertainty of the creditworthiness of banks in the recent market turmoil, extreme caution has been followed and many other institutions have been removed from the counterparty list in line with delegated powers. The limits and time periods for investments have also been revised so that any new investments are placed only with AA rated institutions for short periods.

External Debt Prudential Indicators

57. The external debt indicators of prudence for 2008/09 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£66 million
Operational boundary for external debt:	£56 million

Against these limits, the maximum amount of debt reached at any time in the first three quarters of the financial year 2008/09 was £52 million.

Treasury Management Prudential Indicators

58. The treasury management indicators of prudence for 2008/09 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 2008/09 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 2008/09 was as follows: -

Maturity Period	Upper Limit	Lower Limit	Maximum	Minimum
Under 12 months	30%	0%	5%	0%
12 months and within 24 months	30%	0%	2%	0%
24 months and within 5 years	30%	0%	12%	4%
5 years and within 10 years	30%	0%	4%	1%
10 years and above	95%	50%	87%	81%

(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 2008/09. No such investments have been placed during 2008/09.

(D) Internal Audit

59. Since the last financial review the Head of Internal Audit has prepared a summary report on the audit work completed for the period April – December 2008, and also the planned work to be undertaken by the year-end. The report is attached as Appendix D for Members' information. The main findings of the stores report were reported in the last financial review and copies of the budgetary control, general ledger and asset management reports are attached as Appendix E to this report. The results were:

- Budgetary Control – Adequate
- General Ledger – Substantial
- Asset Management – Adequate

An adequate evaluation indicates the control environment and systems are operating effectively although some slight improvements have been identified. Officers plan to implement all the identified improvements in 2008/09.

60. MFRS officers are still considering the draft grant report and this will come to Members for their consideration in the quarter 1 review report next year.

(E) Monitoring of Financial Progress

61. 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 and Debtors.

Prompt Payment of Invoices

62. Prompt payment of invoices was an indicator under the Best Value legislation and the Authority continues 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.

63. A comparison of third quarter performance over previous years confirms that system improvements continue to enable the Authority to pay invoices (some 1,500 per month) more promptly.

2005/06	97.9%
2006/07	99.7%
2007/08	99.8%
2008/09	99.9%

64. The target for prompt payment set by Government for 2008/09 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 13,682 out of 13,696 invoices being paid within the timeframe.

65. The Authority has been making payments to suppliers by BACS for a number of years. Where possible we will only pay suppliers / employees by cheque as a last resort. This initiative is consistent with the objective to, where possible, conduct business electronically in compliance with government targets. In the period since April 2008 some 96% of all invoices/expense claims have been made electronically.

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

Processing Expense Claims & Sales Invoices

67. Performance indicators have also been developed to monitor the turnaround of 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.

68. The agreed turnaround targets are:

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

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

	2006/7	2007/8	2008/09
Petty cash reimbursements	96%	100%	100%
Sales Invoice Production	86%	90%	91%
Reminders	86%	84%	84%
Expense payments	100%	100%	97%

70. 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 three-year period.

Debtors Process

71. 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.

72. 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

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

Number of debts 60 days+

	2006/7	2007/8	2008/09
October	69	113	107
November	56	84	113
December	68	80	114

Value of debts 60 days+

	2006/7 £'000	2007/8 £'000	2008/09 £'000
October	129	207	299
November	97	191	436
December	127	346	291

74. 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. The increase in the value of debt in 2008/09 is attributable to success in attracting external funding for WFG08, nearly all significant outstanding WFG08 invoices had been paid by the end of January, 2009.

75. Appendix F outlines those debtor accounts under £5,000 that the Executive Director of Resources has approved for write-off since the last financial review. 7 debtor accounts at a value of £3,998.01 (net of VAT) have been approved for write-off.

Equality & Diversity Implications

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

Financial Implications & Value for Money

77. See Executive Summary for financial implications.

78. Sound budgetary management and the delivery of services within the approved budget helps the Authority deliver on its corporate aim of operating efficient and effective organisational functions that will support the core functions of the Authority in a way that provides value for money for the communities of Merseyside.

Contribution to Achieving the Vision
"To Make Merseyside a Safer, Stronger, Healthier Community"

79. Sound budgetary management and the delivery of services within the approved budget helps the Authority deliver on its corporate aim of operating efficient and effective organisational functions. It ensures that those services allocated funding in the approved budget to deliver the Authority's vision can through good financial management fund the activities anticipated in the financial plan to deliver the expected outcomes.

Health & Safety and Environmental Implications

80. Not applicable.

BACKGROUND PAPERS

Report CFO/52/08 “MFCDA Budget and Financial Plan 2008/2009-2012/2013” Authority 21st February 2008.
Report CFO/131/08 “Revenue Outturn 2007-2008 & The Statement of Accounts” Authority 26 June 2008.
Report CFO/147/08 “Financial Review 2008/09 – April to June Review” Policy & Finance Committee 17 July 2008.
Report CFO/99/08 “Update on Firebuy and MFRA procurements in response to national contracts” Authority 15 May 2008
Report CFO/244/08 “Financial Review 2008/09 – April to September Review” Strategy & Resources Committee 18th December 2008.

Glossary of Terms

CFR – **Capital Financing Requirement** – measures the amount of capital spending that has not yet been financed by capital receipts, capital grants or contributions from revenue income. It measures the underlying need to borrow for capital purpose, although this borrowing may not necessarily take place externally (use of available cash etc).

CFS – Community Fire Safety

HFSC – Home Fire Safety Check

LLAR – Low Level Activity Risk

MRP - MINIMUM REVENUE PROVISION - An amount set aside from revenue towards the repayment of loan debt.

PFI - PRIVATE FINANCE INITIATIVE – a central government initiative which aims to increase the level of funding available for public services by attracting private sources of finance. The PFI is supported by a number of incentives to encourage authorities’ participation.

RESERVES -Amounts set aside to meet future contingencies but whose use does not affect the Authority’s net expenditure in a given year. Appropriations to and from reserves may not be made directly from the revenue account.

Supported Borrowing – Borrowing to fund capital expenditure that through the Revenue Support Grant receives grant support to cover the revenue costs associated with borrowing (interest / debt repayment)

Unsupported Borrowing – No Revenue Support Grant to cover the costs associated with borrowing and the Authority must earmark revenue funds to cover these costs.