RESERVES AND BALANCES

Background

1. Section 32 of the Local Government Finance Act 1992 requires that, when calculating the budget requirement for the forthcoming year, authorities should have regard to the level of reserves needed to provide sufficient resources to finance estimated future expenditure and any appropriate allowance that should be made for contingencies.

2. In February 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) published Local Authority Accounting Practice (LAAP) Bulletin 55 'Guidance Note on Local Authority Reserves and Balances' to provide best practice guidance to authorities on the use and management of reserves and balances. More recently the Audit Commission published a report called 'Striking the Balance' which detailed findings from research undertaken during 2012 on the level of reserves that councils held. Pertinent points from this review are discussed later in this Appendix.

3. The External Auditors are required to review and report on the level of reserves and balances but it is not the responsibility of the auditors to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general. The External Auditors will review the process used to determine and approve the level of reserves, to provide themselves with evidence that the authority has strong financial management in place and to help determine whether or not an authority's financial standing is soundly based.

4. In accordance with the CIPFA guidance, authorities should consider the establishment and maintenance of reserves when preparing the annual budget and reviewing their Medium Term Financial Plan (MTFP). This updated review considers the strategic, operational and financial risks facing the Authority over the medium term and seeks to ensure that, as a minimum, there are sufficient balances to support the budget requirements and provide adequate contingency for budget risks. In a time of significant austerity this becomes increasingly more important.

5. In 2010/11 Members agreed that over the medium term, the Authority should look to maintain general reserves to equate to 6% of the net revenue budget. In 2012/13 £48k was transferred to maintain this reserve at the appropriate level. This document presents for Members the outcome of the annual review of reserves and proposals for 2013/14.

Strategic Context

6. Despite the Authority facing significant financial restraint, effective sustainable planning has enabled it to undertake a build programme to provide five new fire stations in strategic locations as well as a new road safety centre. The Authority will

continue to face significant year on year reductions in funding for the foreseeable future. Consequently, in planning for these reductions, the Authority will endeavour to minimise any potential impact on front-line services. In times of financial constraint, it is always prudent to maintain an appropriate level of reserves and it is therefore proposed that general reserves be maintained at 6% of the net revenue budget. Reserves continue to play an important part in the Authority's medium term financial strategy as they assist in ensuring long term budgetary stability. They will enable the Authority to manage changes to budget requirements without undue impact on Council Tax, and contribute to the Authority's strong financial standing and resilience.

7. The Authority therefore holds reserves in order to mitigate future risk such as for increased demand and costs, to help absorb the costs of future liabilities, or to temporarily plug a funding gap should resources be reduced suddenly. Reserve balances also enable the Authority to resource one-off policy developments and initiatives without causing an unduly disruptive impact on Council Tax. Reserves only provide one-off funding and the Authority aims to avoid using reserves to meet ongoing financial commitments other than as part of a sustainable budget plan.

8. In December 2012 the Audit Commission produced a report 'Striking the Balance' which detailed findings from research undertaken during 2012 on the level of reserves held by councils. The report highlighted a number of recommendations that would help improve councils' decision-making around reserves. Members may be pleased to note that this Authority has, for many years, applied the majority of the recommendations in that report. Whilst the report does not specifically separate out fire and rescue authorities, it does highlight that single-tier authorities and county councils hold between 8% and 106% of their net revenue spending in total reserves, with the average being 27%. The total of this Authority's general and earmarked reserves equates to 36% of the 2013/14 net revenue budget.

Types of Reserve

9. There are two different types of reserve: general reserves and earmarked reserves, each of which is described below.

10. **General reserves** - provide a working balance to help cushion the impact of uneven cash flows, help avoid unnecessary temporary borrowing, and also provide a contingency to cushion the impact of unexpected events or exceptional costs. At the end of each financial year any unallocated surplus or deficit on the revenue account may be transferred into, or from, general reserves. General reserves would not be used without Members' approval.

11. **Earmarked reserves** - are sums specifically set aside to provide funds to meet future known or predicted expenditure or liabilities. Typically, earmarked reserves are used to smooth the impact on the revenue budget (and Council Tax) of expenditure that would otherwise cause significant fluctuations in the annual budget requirement as is the case for expenditure on the replacement of vehicles and equipment.

Earmarked reserves are also of use where there may be plans to introduce a policy change which would lead to a one-off increase in expenditure for which additional resources are required, or where there is a future budget liability or pressure which is known but for which the timing of payments or change in funding is uncertain. Reserves are key tools to manage these risks. For each earmarked reserve there is a clear protocol setting out the reason/purpose of the reserve, how and when the reserve can be used, procedures for the reserve's management and control, and a process and timescale for review of the reserve to ensure continuing relevance and adequacy.

12. **Risk Assessment to Determine the Adequacy of the General Reserve** - the most robust means of assessing the adequacy of the Authority's general reserve is through a comprehensive financial risk assessment, which determines the degree to which the Authority is exposed to uninsured and unbudgeted losses. This must be done with knowledge of the context in which the Authority operates. A well-managed authority with a prudent approach to borrowing should strive to maintain as low a level of general reserves as possible, whilst still covering its financial risks. The Authority is a single-purpose authority with responsibility for delivering an emergency service, and it therefore has no opportunity to use cross-service subsidies to meet unanticipated expenditure, which could easily arise due to the volatility of demand-led activity. As previously documented in the Authority's Corporate Governance Assurance Statement, the Authority has a robust approach to managing risk and there are effective arrangements for financial control already in place. That said, given the high level of influence that third parties, such as the Local Government Employers and Government Departments have on its income and expenditure, there is always a risk that the Authority will become liable for expenditure that it has not budgeted for, the impact of which must be mitigated by holding reserves.

13. A summary of the financial risk analysis is shown in **Annex 1**. The risk of financial loss can come from a wide variety of places, and although the list at Annex 1 is comprehensive, it is by no means exhaustive. The risks have again been assessed in the context of the Authority's overall approach to risk management and internal financial controls. This information has then been used to determine the optimal level of reserve holdings needed to meet the requirements of the contingency and working balance, details of which are covered later in this document.

14. There are some positive changes to budgetary risks facing the Authority but with the continued weak economy, concerns over liquidity of banks and the continuing reduction in financial resources available to public services, this suggests that a prudent approach should continue to be adopted.

15. **Analysis of Need for the Working Balance** - Since it became a precepting authority, the Authority has been able to hold a general reserve and earmarked reserves. As these reserves are largely cash-backed, any instance of exceptional expenditure or delay in receiving income is unlikely to lead to the Authority having to

borrow temporarily (or going overdrawn). A significant proportion of the Authority's budget is related to employee costs which are paid monthly so much of the cash flow of the Authority is evenly spread across the financial year. Income from precept and formula grant payments are also paid to the Authority in regular instalments. However, there are areas within the Authority's business that do fluctuate from month to month. Cash balances may also be run down temporarily when the timing of treasury decisions to borrow funds means that actual borrowing to fund capital expenditure may not be made until some time after capital payments have been made. **Annex 2** details the potentially most significant cash flow fluctuations that might arise.

16. **Proposal for the Level of the General Reserve** - The financial risk assessment indicates that, in the worst case scenario, the Authority could require reserves at a level equivalent to 16% of the proposed net revenue budget, should all of the potential risks happen concurrently and at their most extreme. Although it would be extremely unlikely for all of the risk areas to impact at the same time, it is perceivable for a number of them to be co-dependent, for example a major disaster could result in exceptional activity which could affect contractual obligations, put pressure on equipment and systems and result in an insurance loss. The mid-point between the low and the high values is 8%, but regard is given to the likelihood of each risk occurring and the optimum level of general reserve.

17. The risk assessment has been reviewed for its relevancy to future years spanned by the MTFP. The Authority, along with all other public sector bodies, will continue to face significant financial challenges over the medium term. Significant reductions in Government funding between 2011/12 to 2014/15, compounded by rising costs against many areas, all have the potential to impact front line service delivery. With the new changes in local government funding due to take place from April 2013, such as the partial retention by councils of locally collected business rates to replace some Government funding, the transfer in responsibility for Council Tax support to district councils, at the same time as a 10% cut in the funding support, the full extent of the impact of these changes is not yet clear. Uncertainty continues around further funding reductions that might result from the Government's deficit reduction plans for 2015/16 and 2016/17. Indications are that these financial challenges are leading many councils to hold on to, or build up, their reserves to provide financial resilience in years to come. It is therefore prudent to maintain general reserves at 6% of the net revenue budget for at least the foreseeable future. Members are asked to agree to this proposal, which would result in a general reserve of £4,244k for 2013/14, which would be sufficient to meet the revenue running costs of the Authority for just under 22 days.

18. **Assessment of Need for Earmarked Reserves** - Since the Authority became a precepting body, Members have agreed, in principle, to the establishment of a number of earmarked reserves. Each year the relevance of each of these is

reconsidered and Members are informed of the latest plans for the balances held in such reserves.

19. A commentary on the purpose and planned use of each of the current earmarked reserves is detailed below:-

(a) **Business Continuity Reserve** - A Business Continuity reserve was established to support the Authority in funding any additional costs agreed by the Chief Executive and Director of Finance and Corporate Services that might arise as a result of an unavoidable interruption to the continuity of service provision. The balance at 31 March 2013 is forecast to be £500k.

(b) **Fire Control Reserve** - This reserve was established to meet any additional costs arising from the implementation of the FireControl and FireLink projects, over and above funding provided by central government under New Burdens. When the Regional Control Project was cancelled the Authority co-located its Control Centre to Police Headquarters and is in the process of procuring new mobilising equipment and a new system. The balance on the reserve at 31 March 2013 is £575k and it is proposed that £504k of this reserve be used in 2013/14 against costs to be incurred in co-locating Control and implementing the new mobilising system. The Authority has made a successful bid for £1,800k of new Government grant to further support this transition.

(c) **Fire Museum Reserve** - Some years ago the Authority was bequeathed a sum of £29k for improvements to the museum, specifically in relation to the housing of some of the old vehicles. In accordance with the policy agreed by Members, interest accrues on this balance and by 31 March 2013 the balance will have increased to nearly £46k.

(d) **Government Grants Reserve** - This reserve is used to carry forward unspent Government grants at the end of the financial year for projects such as the ongoing support of the Enhanced Command Support capability and other related resilience (formerly New Dimensions) work. Such grants have been received for a variety of different initiatives, usually as Section 31 grants, which means that they are not ring-fenced. However, the Authority always seeks to ensure that these grants are used as far as possible for the purposes for which they were intended, and as a result needs to be able to carry unspent balances forward for the completion of the associated projects. At the beginning of 2012/13 unused grants totalled £1,487k, of which £534k is forecast to be spent in the current financial year. The balance at 31 March 2013 is forecast to be £953k. Further detail on these grants is shown in **Appendix 1** to this report.

(e) **Improvement and Efficiency Reserve** - This reserve was created to pump prime improvement and efficiency initiatives and to facilitate the funding of any potential future redundancy costs. The balance at 31 March 2013 is forecast to be £938k.

(f) **Insurance Reserve** - This is a new reserve which has been established to help smooth the volatility of settling claims across several financial years. In previous years insurance underspends have arisen at short notice, especially at year end, as further information is received on the settlement of claims from the relevant insurers. It is proposed that £160k be moved from the general reserve to create this new reserve.

(g) **Local Government Resource Review** - The changes to the funding mechanism for Local Government introduced following the Local Government Resource Review transferred significant levels of financial risk to the Authority. These risks relate to the localisation of Council Tax Benefit where it is anticipated that higher levels of non-payment will be experienced together with higher than anticipated growth in discounts awarded. The other major area of financial risk relates to the Business Rates Retention Scheme where significant fluctuations in income might arise from the appeals process, business growth/reduction and collection rates. Given that both of these activities are being introduced for the first time in April 2013, it seems prudent to carry an earmarked reserve which can be later reviewed as experience is gained of the new system. It is estimated that it would be appropriate to set a reserve of £500k, at least for the initial year of these new schemes.

(h) **Infrastructure Reserve** - This reserve is used to fund expenditure on infrastructure assets (premises, environmental, IT and communications equipment as well as vehicles and operational equipment). The Infrastructure Plan includes a significant programme of investment in new station builds over the medium term. As with all capital build projects of this size and nature, the profile of actual spend can vary significantly between years. In addition the Infrastructure Plan also reflects the purchase of a significant number of light and heavy fleet vehicles over the medium term. The funding held in this reserve will be utilised as and when capital spend is incurred.

(i) **Performance Reward Grant (PRG) Reserve** - An element of the PRG received by the Authority was paid as revenue funds. These are funds that are held in an earmarked reserve until such time as the relevant expenditure has been incurred. At the end of 2012/13 the closing balance on this reserve is forecast to be £416k.

(j) **Rolling Budgets Reserve** - The annual budget is developed to meet the costs of the purchases and services planned for that financial year. However, in line with accounting principles, any goods or services that are delivered after 31 March 2013 are unable to be accounted for within the 2012/13 financial year. This has traditionally resulted in an underspend in one financial year and an overspend in the following year. To enable all planned costs to be contained within budget, Members have approved the establishment of a reserve to carry forward budget, for which there was planned spend, but for which the goods or services have not yet been delivered (typically over £2,000). The reserve is simply used to roll the amount forward into the accounts of the following year to allow payment once the purchase is complete. At the end of 2011/12 £955k was held in the rolling budget reserve, and £785k has been utilised in 2012/13. The remaining £170k will be used in 2013/14 and 2014/15 for commitments arising from the Light Fleet review.

20. The planned movement on each on the earmarked reserves is shown in the following table:

General and Earmarked Reserves	**31/3/12 Balance £'000**	**2012/13 Transfers £'000**	**31/3/13 Balance £'000**	**2013/14 Net Transfers £'000**	**31/3/14 Balance £'000**
General Reserve	**4,356.3**	**48.0**	**4,404.3**	**-160.0**	**4,244.3**
Earmarked Reserves					
Business Continuity	500.0	0.0	500.0	0.0	500.0
Fire Control	575.2	0.0	575.2	-504.3	70.9
Fire Museum	45.1	0.3	45.4	0.3	45.7
Government Grants	1,487.0	-534.4	952.6	-514.9	437.7
Improvement & Efficiency	938.4	0.0	938.4	0.0	938.4
Local Government Resource Review	0.0	0.0	0.0	500.0	500.0
Insurance	0.0	0.0	0.0	160.0	160.0
Infrastructure	14,069.9	4,047.1	18,117.0	-5,481.5	12,635.5
Performance Reward Grant	679.2	-263.0	416.2	-254.0	162.2
Rolling Budgets	954.5	-784.6	169.9	-126.3	43.6
Total Earmarked Reserves	**19,249.3**	**2,465.4**	**21,714.7**	**-6,220.7**	**15,494.0**

Proposed Reserve Levels

21. The levels of reserves recommended in this report for the financial year 2013/14 and the medium term are believed to be sufficient to meet all of the Authority's obligations and have been based on a detailed risk assessment.

22. In line with the proposed policies on the control and management of these funds the limits will be reviewed on an annual basis against prevailing risk assessments and other information. The actual movement of earmarked reserves in 2012/13 will be shown in the Annual Statement of Accounts, once the final position is known at the end of the financial year.

Risk Assessment for General reserves

Low Risk - Unlikely to occur, the organisation has taken steps to mitigate potential risk.
Medium Risk - Possible occurrence, moderate concern and impact.
High Risk - Has occurred regularly before or is a significant financial impact which the organisation cannot control.

Risk	**Likelihood & Value of Risk** **£'000**
Natural disasters, national emergencies and prolonged periods of operational activity	0 - 140 Low
The Bellwin Scheme provides financial assistance to local authorities in the event of a national emergency or disaster, subject to an authority contributing to the total costs by an amount equivalent to 0.2% of its approved budget. For the Authority this would require approximately £140k.	
In addition to this there could be local large-scale incidents or periods of high activity, due to local weather patterns which would not meet the criteria laid down within the Bellwin Scheme. Expenditure incurred following acts of terrorism is currently excluded from Bellwin Scheme arrangements.	0 - 1,000 High
It is difficult to anticipate the cost of a potential disaster that could have a detrimental effect on the service, but it could be significant. Covering the cost of introducing new working practices (e.g. home working facilities and on-call payments), enhanced welfare and protective equipment, plus increased legal claims in the event that service delivery is detrimentally affected.	0 - 500 Medium

Risk	Likelihood & Value of Risk £'000
Unanticipated Business or Economic Pressures	
The Authority has a wide range of contractual arrangements which could see a financial loss in the event of the bankruptcy of a supplier or a customer. Although the Authority maintains a bad debt provision it is unlikely to be able to fully fund a loss from a major contract.	0 - 1,400 Medium
The Authority's surplus cash balances which are available for investment have ranged this year between £24m and £39m. Most is deposited in the Government's Debt Management Office Account which, whilst secure, delivers a very low rate of interest. The Authority still has a share in KCC's Icelandic investments and has made prudent provision in line with appropriate guidance for any potential loss.	0 - 400 Low
Public sector procurement bodies are increasingly likely to be subject to challenge and litigation from unsuccessful bidders in tendering exercises or from suppliers not invited to submit bids in the first place. In the event that this should arise, the Authority will need to cover the legal costs of responding to such potential challenges and to account for any potential reparation costs awarded to successful claimants by the courts.	0 - 200 Low
In the event that a key system, such as the control mobilising system, were to fail, it is possible that urgent consultancy or replacement equipment would be required, and this could, due to the short notice, be costly.	575 - 3,000 Low
Currently the Authority has a base budget which covers approximately one third of the aggregate stop loss on insurance claim excesses. Any significant excess will need to be met from general reserves.	0 - 160 Low
Pension Liabilities	
Over recent years there has been a significant reduction in the number of employees retiring on ill health grounds. In 2012/13 budget provision was made for two ill health retirements (one higher and one lower). Currently no retirements on ill health grounds are confirmed for 2012/13 but this position could change by 31 March 2013 causing a budget pressure next year.	0 - 150 High
Inflationary Increases	
A 3% allowance has been made for inflationary increases at the time that the budget was being developed. However, some contracted services are driven by a strong market where escalating prices cannot always be negotiated down through competition. It is usually possible to offset such pressures against in-year underspends or to re-phase planned purchases into later years, giving sufficient time for the price increases to be budgeted for. The	0 - 300 Medium

Risk	**Likelihood & Value of Risk** **£'000**
Authority also continues to be exposed to global economic inflationary pressures primarily relating to oil based and other natural resources. The level of interest rates prevailing during the financial year impacts on both rates for long term borrowing and the level of investment income achieved. A 1% difference in short term rates could change the investment income by £50k - £100k depending on the level of cash balances held. To date all of the Authority's long term borrowing has been at fixed interest rates thus eliminating any exposure to interest rate risk.	50 - 100 Medium
Legal Issues	
Given the nature of the work of the Authority there is a possibility that it could suffer a major health and safety or environmental failure. Although this could result in a substantial cost, the Authority's Risk Register details the controls that are in place to mitigate against this risk.	0 - 750 Low
It would be prudent for the Authority to make provision for an unfavourable outcome of any legal action taken against it, which could be made on a range of different grounds, including equal pay, discrimination and corporate manslaughter. Such awards are usually significant and a sum of up to £500k would not be unusual.	0 - 500 Low
The introduction of the Regulatory Reform (Fire Safety) Order 2006 means that FRAs are responsible for enforcement and does therefore mean that the risk of legal challenge to such notices could arise, the costs of which could exceed existing revenue budget provision.	0 - 100 Low
Employment Issues	
Issues that might arise in respect of pay settlements or other factors which might lead to industrial action are now dealt with in the assessment of the business continuity reserve.	
The Tribunal ruled in favour of retained employees on the Part Time Workers (Prevention of Less Favourable Treatment) case. However, the financial ramifications in respect of potential backdated employer pension contributions, together with other associated costs such as sick pay, could be so significant nationally that it is hoped that the Government would introduce measures to mitigate the impact on FRAs. However, this is not certain and, in the event that FRAs were called upon to pay these backdated costs, the Authority's exposure to pension costs alone could be up to a maximum of £7.5m based on a 100% take up by retained staff who served from April 2000 to March 2006.	0 - 1,700 Medium

Risk	Likelihood & Value of Risk £'000
In this situation the position with regard to ongoing costs is less clear and FRAs may well be expected to provide for increased costs going forward. If it were assumed that the take up would be similar to those part-time firefighters that joined the new 2006 Firefighters' Pension Scheme, the cost would equate to the difference between the 1992 and 2006 scheme employer contribution rates up to 31 May 2011 when new part-time on-call contracts were introduced. At the current level of take-up this would be circa £1,000k but this is by no means certain. The difference between estimated employer contributions paid for retained staff since April 2006 to 31 May 2011 and a scenario where all the then retained staff opted to join the 2006 pension scheme would be circa £3.4m.	0 - 1,000 Medium
Total Exposure to Financial Loss	**625 (0.8%) – 11,400 (16%)**

Analysis of Need for the Working Balance

Cash Flow Pressure	**Likelihood & Impact** **£'000**
Additional activity payments These payments will be heavily influenced by operational activity with the payment for the hottest summer months being a large proportion of the total for the year.	Medium 0 - 250
Firefighter pension lump sum payments These payments can be made at short notice with the amount depending on earnings and length of service.	Medium 0 - 300
Business rates The Authority receives its business rate demands in April each year for immediate payment. This means that the cost of the rates bill significantly raises the cash flows out of the Authority each April.	High 0 - 1,000
Payment of precept, revenue support grant and national non domestic rates (NNDR) Following the Localism Act 2011 and the Local Government Finance Act 2012, responsibility for collection of Business Rates and decisions on levels of Council Tax support will pass to local authorities. This will mean that the Authority may have a greater exposure to the risk of non-payment and the impact of additional support. The impact assessment is based on modelling exercises that have been performed to assess the exposure to variations in collection amounts.	Medium 200 - 1,900
Timing of borrowing decisions The decision to borrow long term funds will be based on consideration of money market conditions and other factors, so funds may not be secured until some time after capital payments have been made. The Authority may, from time to time, decide to roll forward one year's borrowing requirement to the next, temporarily using cash balances for funding or, in certain circumstances, bring forward expenditure planned for future years.	High 1,800 - 4,500

Capital purchases and disposals Operational vehicles represent one of the largest-value assets that the Authority regularly purchases and the timing of these purchases can result in large cash outflows falling in some months. The capital programme includes plans to purchase sites and build five new fire stations. This is likely to give rise to large cash payments. The Authority expects to dispose of some property over the next few years but the timing of the sales and receipts will be uncertain.	High 0 - 4,500 0 – 7,900 0 - 500
Pension Account The Pension Account is a separate account to that of the Authority, with any difference between pension payments and employer contributions being met from Government grant. The Government normally makes just one yearly payment each July, comprising 80% of the net estimated payments for the current year plus any adjustment for amounts due in respect of the previous year. Any difference between payments made and income received is reflected in the Authority's cash position. The numbers of ill health retirements and normal retirees are difficult to predict (now that there is no compulsory retirement age) and this can give rise to under and overpayment of grant.	High 0 -1,800