



DEVON & SOMERSET FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	DSFRA/09/13
MEETING	DEVON & SOMERSET FIRE & RESCUE AUTHORITY
DATE OF MEETING	27 MAY 2009
SUBJECT OF REPORT	RISK ASSESSMENT OF AN ADEQUATE LEVEL OF GENERAL RESERVES
LEAD OFFICER	Treasurer
RECOMMENDATIONS	<i>That the adequacy of the current levels of reserve balances, as highlighted in this report, be noted.</i>
EXECUTIVE SUMMARY	<p>The Authority, when setting its budget and council tax levels for the current year, debated amongst other things an appropriate level of general reserve to be held by the Authority and asked that a report be submitted to a future meeting setting out a risk assessment in relation to the level of reserves (Minute DSFRA/754(c) refers).</p> <p>This report now sets out that information.</p>
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	No potentially negative impact sufficient enough to warrant a full impact assessment has been identified in the content of this report.
APPENDICES	A. Estimated Minimum Reserve Levels
LIST OF BACKGROUND PAPERS	Report DSFRA/09/5 (Statement on the Robustness of the Budget Estimates and Adequacy of the Devon and Somerset Fire and Rescue authority's Levels of Reserves) as considered by the Authority at its budget meeting on 16 February 2009.

1. LEGISLATIVE BACKGROUND

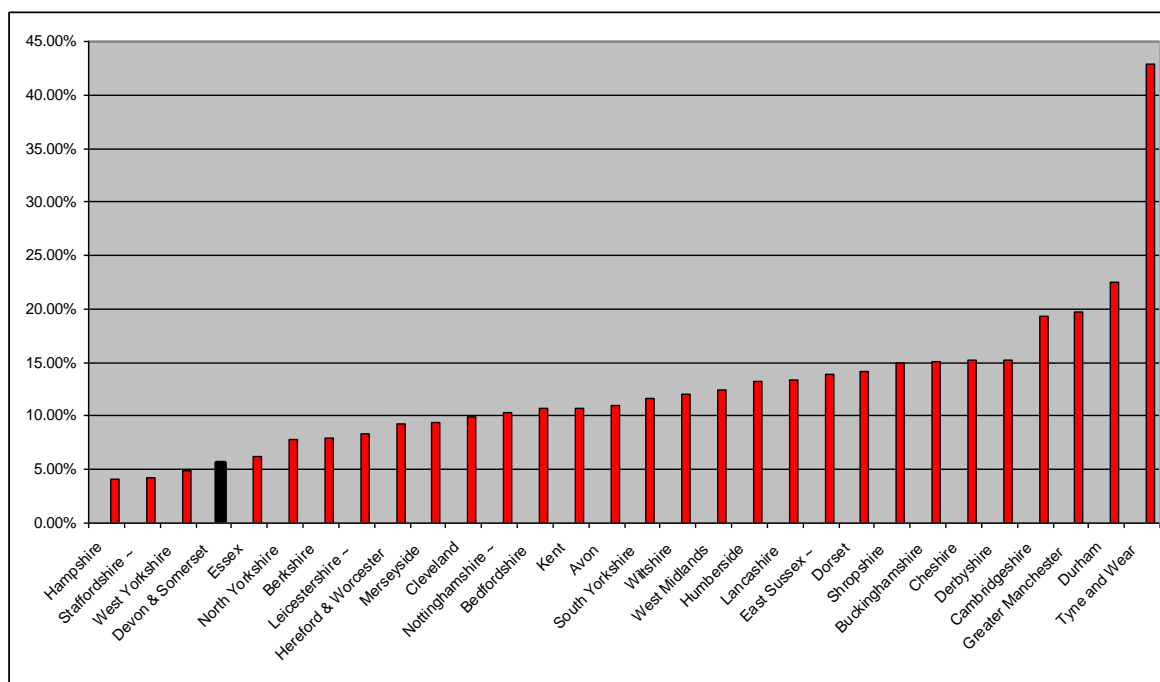
- 1.1 Sections 32 and 43 of the Local Government Finance Act 1992 require precepting authorities, such as Devon & Somerset Fire & Rescue Authority (DSFRA), to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement. In addition there are also a range of safeguards in place that help to prevent authorities over-committing themselves financially. These include:
- A duty to set a balanced budget;
 - The Chief Finance Officers duty to report on the robustness of estimates and adequacy of reserves;
 - The legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the chief finance officer has responsibility for those administration of those affairs (Section 112 of the Local Government Finance Act 1988 – this is, for combined fire and rescue authorities, a provision analogous to Section 151 of the LG Act 1972);
 - The requirements of the Prudential Code relating to capital financing
 - That the auditors will consider whether the Authority has established adequate arrangements to ensure that their financial position is soundly based;
 - The requirement that the Chief Finance Officer reports to the Authority's Members if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include a situation where the authority's reserve levels have become seriously depleted, through utilisation, that the authority will not have sufficient resources to meet its expenditure in a particular financial year. In such a position the Authority would be prohibited from entering into new agreements involving the incurring of expenditure.
- 1.2 As part of its budget setting process at the meeting held on 16 February 2009, the Authority considered the report 'Statement on the Robustness of the Budget Estimates and Adequacy of the Devon and Somerset Fire and Rescue Authority's Levels of Reserves' to help inform decisions regarding budget setting. This report included information regarding current reserve levels and a review of its adequacy as regards meeting future unforeseen expenditure.
- 1.3 As part of the budget setting deliberations on 16 February 2009 the Authority also asked that a further report be submitted to a future meeting on the risk assessment associated with determining an appropriate level of general reserve.

2. REVISED ASSESSMENT OF MINIMUM LEVEL OF GENERAL RESERVE

- 2.1 A revised assessment indicates that a minimum level of general reserve to be held is £4.126m. Appendix A provides a detailed analysis of the financial risks included in this assessment. The actual level of general reserve held is £4.453m (including the proposal, considered elsewhere on the agenda, that a contribution of £0.162m be made from the 2008/2009 underspend).
- 2.2 The current levels are only slightly in excess of the minimum requirement, by an amount of £0.327m, and given the current financial climate and external factors not included in the minimum assessment, e.g. any adverse changes to future funding levels from the next Spending Review and expected capping criteria, it is my view that the current levels can only be regarded as adequate but not excessive.

- 2.3 It should also be emphasised that this revised assessment has been made on the basis of a minimum level of reserve balance, and not a maximum, and that should there be a need to utilise reserves during 2009/2010, then the Authority will need to consider action to replenish reserve levels.
- 2.4 The issue of adequate reserve levels has been very much in the spotlight within the last twelve months following the deterioration of the global banking system and the potential loss of some local authority investments from the Icelandic banks. This issue led to the release, by the Chartered Institute of Public Finance and Accountancy (CIPFA), of a revised Local Authority Accounting Practice (LAAP) Bulletin in November 2008 to provide further guidance on best practice as regards local authority reserves and balances. The key message from this bulletin was a reminder to Chief Finance Officers, in particular, of the importance of reviewing reserve balances to ensure that levels are adequate based upon changing circumstances. Whilst the DSFRA was not directly impacted by the Icelandic bank situation, as these banks are not included on the list of financial institutions that we invest with, it was - during the previous year (2007) - exposed by the problems of Northern Rock at the time that that bank was in trouble.
- 2.5 The level of reserve balances held are also subject to scrutiny as part of the external auditors role to consider whether the Authority has established adequate arrangements to ensure that its financial position is soundly based. This work will include an assessment of reserve levels, albeit that it is not the responsibility of the auditor to advise as to what are minimum or maximum levels. The most recent assessments by the Audit Commission, relating to the 2007/2008 Accounts and the 2008 Use of Resources Assessment, have provided reassurances that there are no concerns with regard to reserve balance levels and the strategy for maintaining reserves.
- 2.6 A level of general reserve balance of £4.453m is equivalent to 6.1% of the net budget requirement. Whilst comparable figures are not yet available for other fire and rescue authorities as at 31 March 2009, Table 1 overleaf compares the Authority general reserve balance with other fire and rescue authorities in England and Wales for the previous financial year, i.e. balances as at 31 March 2008. Based on these figures, a reserve balance equivalent to 6.1% places the Authority in the lower quartile, the average balance being 13.5% of revenue budget - Upper Quartile 15.0% and Lower Quartile 8.0%. At 6.1% the Authority balances are in fact 4th lowest in the country of all FRAs, being 29th out of 33.

TABLE 1 - ANALYSIS OF FIRE AND RESCUE AUTHORITY GENERAL RESERVE BALANCES AS AT 31 MARCH 2008



3. **SUMMARY**

3.1 An important part of the financial planning process is for levels of reserves and balances to be regularly reviewed to ensure that they are adequate to meet future spending requirements. This report provides Members with the outcome of the most recent risk assessment as to a minimum level of general reserve for this Authority. This assessment indicates that a minimum of £4.126m should be held, compared to the actual balance currently held of £4.453m.

3.2 Whilst the current balance is in excess of minimum requirements, it should be emphasised that there will inevitably be other factors which have not been included in the most recent risk assessment, for instance, changes in future funding levels arising from the next Spending Review which are very likely to have an adverse impact on financial planning in the medium term. With this in mind is my view that whilst current reserve balances can be deemed as adequate they can by no means regarded as excessive.

KEVIN WOODWARD
TREASURER

ESTIMATED MINIMUM RESERVES REQUIREMENT FOR 2009/2010

TYPE OF RISK	£
<p><u>Under-estimate of pay award</u> A provision is made for the eventuality that the pay award is settled at 1% more than included in the base budget. Total pay cost budget is just over £55m for 2009/2010.</p>	550,000
<p><u>Variation in call-out of retained fire-fighters</u> Spending against the budget for retained pay costs can be susceptible to volatility caused by spate weather conditions.</p>	200,000
<p><u>Phased transition to an improved Retained Duty System</u> Reductions in the number of hours of retained firefighter availability caused by changes introduced as part of the 2003 Pay Agreement, and the potential impact of the European Working Time Directive, has resulted in a review of the existing Retained Duty System. The original assessment carried out by the ex-Devon FRS was that it would need an additional 134 retained firefighters to maintain adequate cover arrangements in Devon.</p>	500,000
<p><u>Insurance funds/excesses on claims</u> A contingency is included for uninsured losses e.g. the write-off of an appliance which is leased, and the potential wind-up of the mutual insurance company (FRAML) in which the Authority has a capital investment.</p>	476,000
<p><u>Adverse impact from Treasury Management investments</u> The deterioration in confidence of the global banking system and the collapse of the Icelandic Banks has highlighted the risk to local authorities of relying on credit rating agencies to inform its investing strategy.</p>	1,000,000
<p><u>Local contribution to major incident covered by 'Bellwin' Scheme</u> Whilst emergency financial assistance from central government is available to assist authorities through the Bellwin Scheme in dealing with the immediate consequences of major unforeseen events (e.g. flooding), the amount of assistance available will not cover all costs, even in exceptional circumstances.</p>	220,000
<p><u>Impact of changes to International Financial Reporting Standards (IFRS)</u> The timetable for the transition from Generally Accepted Accounting Practice (UK GAAP) to IFRS has now been established for local government accounting. The standard requires the first year of IFRS compliant accounts for the financial year 2010/2011 with full comparative data for the previous year 2009/2010, therefore the date of transition is 1 April 2009. The change to the new standards will require new provisions to be made, in particular, authorities will be required to accrue for staff benefits, including paid leave, that are not taken at the balance sheet date. It is anticipated that this will have a significant impact in year 1 of the transition.</p>	850,000

TYPE OF RISK	£
<p><u>Provision for retained staff joining new pension scheme</u> The introduction of a new Firefighters Pension Scheme from April 2006 has for the first time provided retained firefighters with access to a pension scheme. For an organisation such as the Devon & Somerset Fire & Rescue Service (DSFRS), with significant numbers of retained firefighters, this has placed additional financial burden on the revenue budget as new retained firefighters join the Service and an employer's contribution is paid into the Pension Account. Contingency for new joiners over and above that provided for in the base budget is included here.</p>	80,000
<p><u>Provision for additional ill-health retirements</u> Changes to the funding arrangements relating to the Firefighters Pension Scheme from April 2006 have meant that any deficit between annual pension costs and employers/employees contributions are reclaimed from the Department for Communities and Local Government (CLG) on an annual basis. However, pension costs relating to local decisions to retire a firefighter on grounds of ill-health are not able to be reclaimed and are to be funded from the FRS revenue budget. Contingency needs to be made in the event that more ill-health retirements take place than budgeted for.</p>	200,000
<p><u>Potential variations in income</u> Provision is made in the event that income targets, particularly in relation to those income streams susceptible to the impact of the economic downturn, are not achieved e.g. training income and investment returns on working balances.</p>	180,000
<p><u>General contingency (e.g. fuel costs, adverse changes to borrowing rates)</u> An assessment has been made of further costs in the event that fuel costs, in particular, escalate during the year.</p>	190,000
<p><u>Adjustment for pooling of risks</u> A weighted calculation has been made to adjust the level of minimum reserve to reflect the fact that it is highly unlikely that all of the identified risks will occur during one financial year.</p>	(320,000)
ESTIMATED MINIMUM REQUIREMENT OF RESERVES	4,126,000