

REPORT REFERENCE NO.	RC/19/10
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	15 MAY 2019
SUBJECT OF REPORT	RESERVES STRATEGY 2019-20
LEAD OFFICER	Director of Finance
RECOMMENDATIONS	<i>That the Committee recommends the Reserves Strategy to the Authority for publication</i>
EXECUTIVE SUMMARY	<p>The Fire and Rescue National Framework for England introduced a requirement for fire and rescue authorities to prepare and publish a Reserves Strategy setting out the purpose of each Earmarked Reserve, an analysis of the General Fund and the expected timing of expenditure from the reserves. The requirement commenced in 2018 and this is the second such strategy.</p> <p>This report includes a risk assessment of the General Fund and a section on each of the Earmarked Reserves – which it is proposed should be combined into broader categories to simplify the way that Reserves are reported on. It should be noted that this report has been prepared under those new categories.</p>
RESOURCE IMPLICATIONS	As set out within this report.
EQUALITY RISKS AND BENEFITS ANALYSIS (ERBA)	
APPENDICES	<p>A. Risk Assessment of the Adequacy of General Reserves</p> <p>B. Projected Reserve Balances over MTFP</p>
LIST OF BACKGROUND PAPERS	The Fire and Rescue National Framework for England Reserves Strategy 2018-19

1. INTRODUCTION AND BACKGROUND

- 1.1. Section 43 of the Local Government Finance Act 1992 requires that, when setting the budget for the forthcoming year, precepting authorities should have regard to the level of reserves needed to provide sufficient resources to finance estimated future expenditure, plus any appropriate allowances that should be made for contingencies.
- 1.2. Best practice on the use and management of reserves and balances is provided by CIPFA and the Local Authority Accounting Panel (LAAP) guidance, specifically LAAP Bulletin 99 - 'Local Authority Reserves and Balances'. This was issued in July 2014, but since then many references have been made to the scale of public sector reserves by various parties.
- 1.3. In May 2018 the Government published the new Fire and Rescue National Framework for England. This introduces a requirement for fire and rescue authorities to publish a Reserve Strategy on their website and outlines the detail which should be included. The Reserves Strategy can form part of the Medium Term Financial Plan or be a stand-alone document.
- 1.4. The Reserves Strategy for this Authority has been prepared as a stand-alone document for 2019-20 and is subject to adoption of the recommendations in the Draft Financial Outturn for 2018-19.

2. STRATEGIC CONTEXT

- 2.1 There are a number of reasons why a Local Government Authority might hold reserves, these include to:
 - (a) mitigate potential future risks such as increased demand and costs;
 - (b) help absorb the costs of future liabilities;
 - (c) temporarily plug a funding gap should resources be reduced suddenly;
 - (d) enable the Authority to resource one-off policy developments and initiatives without causing an unduly disruptive impact on Council Tax;
 - (e) spread the cost of large scale projects which span a number of years.
- 2.2 Reserves only provide one-off funding so the Authority aims to avoid using reserves to meet regular and ongoing financial commitments, other than as part of a sustainable medium-term budget plan.

3. LONG-TERM SUSTAINABILITY

- 3.1 Reserves are an essential tool to ensure long term budget stability particularly at a time when the Authority is facing significant year on year reductions in grant funding over the medium term. Due to the fact that funding for future Capital Projects is held as an Earmarked Reserve, the overall level of reserves held by the Authority is currently still high, but will reduce significantly as the capital programme progresses.
- 3.2 Reserve balances have been identified as a key indicator of financial health and the Authority continues to have an appropriate level of reserves to deal with identified risks. As a minimum, there are sufficient balances to support the budget requirements and provide an adequate contingency for budget risks.

3.3 There are two different types of reserve, and these are:

Earmarked Reserves – these reserves are held to fund a specific purpose and can only be used to fund spending associated with that specific purpose. Should it transpire that not all of the agreed funds are required then the agreement of the Authority would be sought to decide how any remaining balance is to be utilised; and

General Reserve – usage from this Reserve is non-specific and is held to fund any unforeseen spending that had not been included in the base budget e.g. excessive operational activity resulting in significant retained pay costs.

3.4 In addition to reserves the Authority may also hold provisions which can be defined as: a Provision is held to provide funding for a liability or loss that is known with some certainty will occur in the future, but the timing and amount is less certain.

4. **RISK ASSESSMENT TO DETERMINE THE ADEQUACY OF THE GENERAL RESERVE**

4.1 A well-managed multi-purpose authority will strive to maintain as low a level of General Reserve as possible, whilst still covering its financial risks. As a single-purpose authority, this Authority has no opportunity to use cross-service subsidies to meet unanticipated expenditure and so, proportionally, its General Reserve may be slightly higher than for a multi-purpose authority.

4.2 This Authority has a robust approach to managing risk and there are effective arrangements for financial control 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 unexpectedly become liable for expenditure that it has not budgeted for, e.g. the 2020/21 funding gap on the Firefighters Pension scheme.

4.3 The Authority has set its Prudential Indicator for the General Reserve at 5% of annual budget which is a commonly used benchmark across the Fire Sector. At the start of 2019-20, the General Reserve represented 7.07% of the Authority's net revenue budget which is a positive variance. Due to varying revenue budgets, maintaining a consistent level of General Reserve will result in the percentage varying over time. Transfers in or out of the General Reserve to conform to the 5% indicator would only be considered if there was significant variance or if resources were earmarked to another project.

4.4 The prudential indicator is a useful control measure but is a rudimentary way of assessing the adequacy of the general reserve and a more meaningful approach is to develop a risk assessment. The Authority will consider both measures as part of its annual reserve strategy.

4.5 A risk assessment of the adequacy of the Authority's General Reserve will be carried out annually to determine the extent to which the Authority is exposed to uninsured and unbudgeted losses. The risk assessment for the current financial year, 2019-20, has been expanded on that prepared as part of the budget setting process and is shown in Appendix A. The impact and scale of potential losses has been estimated to calculate a potential net financial impact of £5.216m. At the start of 2019-20 the General Reserve equalled £5.315m and therefore it will not be necessary to amend the amount based on the current risk assessment.

5. ANNUAL REVIEW OF EARMARKED RESERVES

5.1. The Authority has a number of earmarked reserves which have been established for specific purposes where there have been timing differences at budget setting or year end, or emerging risks or cost pressures. The relevance of, and balance in, each of these is reviewed annually and the Authority is informed of the latest plans for the balances held in such reserves over the medium term via the Reserves Strategy. When the Authority approves the Reserves Strategy for publication it will be made available on its website.

5.2. As part of the annual review of reserves 2018-19, Earmarked Reserves were re-categorised and are now presented as below.

Grants received in advance

5.3. These reserves relate to grants which have been given to the Authority which have either not been fully spent or have been received in advance of the intended expenditure period. Where a grant has been received in advance the Authority's policy and accounting rules dictate that the funding be transferred to an Earmarked Reserve to be spent in future years. Specifically, timing differences of £0.917m have arisen from Home Office grants relating to the Airwave communication system, the Authority has a commitment to the expenditure in the following financial year and therefore the funding will be transferred out of reserves and in to the revenue budget.

5.4. Any smaller grants will be reviewed annually as part of the budget monitoring process to assess whether they are still needed. It is not anticipated that any of the current balances will be carried forward beyond the medium term financial plan period of 2019-24.

	Projected	Proposed	Projected	Proposed
	Balance as at	Balance as at	Balance as at	Balance as at
	1 April 2019	31 March 2020	31 March 2021	31 March 2024
	£000	£000	£000	£000
RESERVES				
Grants unapplied from previous years	(1,145)	918	(227)	-

Invest to Improve

- 5.5. A significant amount of funding has been set aside in Reserves to support the change activity within the Service. Following release of the Integrated Risk Management Plan, which addresses Community risk, and the Fire and Rescue Plan, which addresses organisational risk, the Service has developed its Safer Together programme. Invest to Improve reserves will be used to invest in projects such as digital transformation and development of our people which will support the modernisation of the Service. If restructure is required, reserve funding could be required to pay for any associated redundancy costs.
- 5.6. The Authority has approved the Service's Safer Together programme which will identify the requirement to invest in improvement activity and the resulting benefits which will then be fed in to the Medium Term Financial Plan for 2019-20 and beyond. The Invest to Improve reserve will be subject to regular budget monitoring and forecasting by the Service Programme Board. Of the current forecast up to 2022, £3.2m is committed to existing projects with the remaining expenditure being an estimate of the Safer Together programme costs.

	Projected Balance as at 1 April 2019	Projected Spend 2019-20	Proposed Balance as at 31 March 2020	Projected Spend 2021-24	Proposed Balance as at 31 March 2024
	£000	£000	£000	£000	£000
RESERVES					
Invest to Improve	(5,937)	1,500	(4,437)	4,437	-

Budget smoothing

- 5.7. The budget smoothing reserve is intended to support any shortfalls in future revenue budgets which are identified during the development of the Medium Term Financial Plan. The reserve has arisen from a surplus of funding in previous financial years, particularly where non-domestic rates or grant income have exceeded the budget requirement. The Medium Term Financial Plan for the period 2019-20 to 2021-24 has identified a potential funding shortfall of between £8.4m and £13.1m which, if not addressed through changes to the way we work, will need to be funded from reserves.
- 5.8. The Safer Together programme is expected to release significant savings but these will be subject to public consultation and Authority approval. The Reserve may also be used where benefits realised from changes to the operating model are released over several years.

At the moment, it is forecast that the Budget Smoothing reserve will be exhausted within the Medium Term Financial Planning Period.

	Projected Balance as at 1 April 2019	Projected Spend 2019-20	Proposed Balance as at 31 March 2020	Projected Spend 2021-24	Proposed Balance as at 31 March 2024
	£000	£000	£000	£000	£000
RESERVES					
Budget Smoothing Reserve	(1,818)	-	(1,818)	1,818	-

Capital Funding

- 5.9. At £20.0m, Capital Funding is the largest of the Authority's earmarked reserves. There is a long term strategy in place to reduce borrowing to fund capital expenditure and this reserve has been built up over several years from under spends in the Capital Programme along with savings made in other areas. Due to the long term nature of the Capital Programme and low levels of expenditure in recent years the reserve has grown significantly and represents an opportunity to reduce borrowing in the future as well as the associated costs.
- 5.10. If the Authority hadn't taken out any borrowing to fund capital expenditure it could save £1.1m per year in debt charges. Borrowing currently stands at £25.5m and the loan portfolio is regularly reviewed for opportunities to pay off loans where there would be a long term benefit but this is dependent on economic conditions. If the Authority does opt to pay off loans early, use of the Capital Funding reserve will accelerate. Currently it is forecast that the programme will require £3.4m of reserve funding in 2019-20 and for the reserve to be exhausted over the medium term. However, a measured approach has been taken when projecting spend over the 2021-24 period to reflect the current pace of expenditure on the programme. If the Safer Together programme identifies a need for further investment in our Estate, infrastructure, vehicles and equipment the reserve can be called upon to fund the acquisition or enhancements, subject to long-term affordability.
- 5.11. Planning for the Capital Programme is undertaken as part of the annual budget setting programme and so each year the Authority will have the opportunity to review the funding options of the programme. The forecast use of the Capital Funding reserve will be determined by that programme. Given that it is prudent to maintain the long term strategy to reduce, ideally remove, reliance on external borrowing to fund Capital expenditure, a healthy reserve will be maintained wherever possible.

	Projected	Proposed	Projected	Proposed
	Balance as at	Balance as at	Spend	Balance as at
	1 April 2019	31 March	2021-24	31 March 2024
	£000	2020	£000	£000
RESERVES				
Direct Funding to Capital	(19,956)	3,439	10,000	(6,517)

Specific projects, budget carry forwards or risks identified

- 5.12. The Authority holds several Earmarked Reserves for items which have been identified through a business case, to address a specific risk or where timing differences have arisen in the revenue budget. These items form part of the planning cycle but either address a risk or maintain the status quo rather than being potential improvement activities. Examples of this are a refresh of Breathing Apparatus or Personal Protective equipment and replacement roofing. Expenditure on these items will normally be spread over several financial years within the Medium Term Financial Plan but there are instances where a longer term risk has been identified and provided for which may exceed the 2019-2024 period.
- 5.13. These one off reserves will be reviewed annually and either maintained or enhanced. Any unspent funds remaining at the end of the project will, subject to the relevant approval, be transferred to an alternative reserve such as the Invest to Improve or Capital Funding reserve.

	Projected		Proposed		Proposed Balance as at 31 March 2024 £000
	Balance as at 1 April 2019 £000	Spend 2019-20 £000	Balance as at 31 March 2020 £000	Projected Spend 2021-24 £000	
RESERVES					
Projects, risks, & budget carry forwards					
PFI Equalisation	(295)	-	(295)	-	(295)
Emergency Services Mobile Communications Programme	(932)	200	(732)	732	-
Breathing Apparatus Replacement	(1,449)	1,449	-	-	-
Mobile Data Terminals Replacement	(381)	381	-	-	-
PPE & Uniform Refresh	(488)	488	-	-	-
Pension Liability reserve	(461)	-	(461)	461	-
National Procurement Project	(90)	45	(45)	45	-
Budget Carry Forwards	(363)	100	(263)	263	-
Upgrade Wi-Fi & Internet Connection	(75)	75	-	-	-
Respiratory Protection Masks - Personal Fit	(70)	70	-	-	-
Vema Outriggers	(95)	95	-	-	-
Total	(4,700)	2,903	(1,797)	1,502	(295)

5.14. Explanation of specific reserves:

- PFI Equalisation* – The Authority is part of a tri-service Private Finance Initiative which covers the Severn Park training facility. Due to the nature of the contract and its longevity (will mature in 2028) the amount due at the end of the contract is dependent on various factors such as interest rates and investment performance. The reserve is held to mitigate the risk at the end of the contract period.
- Emergency Services Mobile Communications Programme (ESMCP)* – The Authority has committed to be part of the ESMCP national project which provides the technology and network to allow Emergency Services a dedicated method of communication whilst being more financially efficient than its predecessor. Whilst funding has been allocated on a regional basis there is a need to support the project beyond the funding (which has been allocated for discrete time periods) because of the South West region being the last to transition which is why the reserve was established. The reserve also holds grant funding from central government to support the establishment of Emergency Services Network capability. The national project is currently under scrutiny of the Public Accounts Committee and may be subject to change or cancellation. If cancelled, there is a risk that the current Airwave facility will cost the Authority more although at this stage that cannot be quantified.
- Breathing Apparatus Replacement* – The Authority has committed to replacement of aging (and soon to be obsolete) breathing apparatus equipment and has completed a procurement exercise. The new equipment will harmonise sets throughout the Service and improve firefighter safety due to improved functionality including enhanced communications. Delivery of the new sets commenced in May 2019 and so the project will be completed in the 2019-20 financial year.
- Mobile Data Terminals (MDT) Replacement* – MDTs are computers in appliances which provide site specific risk and technical information to firefighters when they respond to incidents. Due to the age of the current suite of MDTs, which are purchased and maintained under the Airwave Communications system, replacements are required in advance of the roll out of the new Emergency Services Mobile Communications Project. Refreshing the safety critical information available to firefighters at incidents supports the Authority's underlying principles of Public Safety and Firefighter safety.

- *PPE and Uniform refresh* – Firefighters are required to wear a specific range of Personal Protective Equipment (PPE) when responding to incidents and each set has a finite life dependant on the number and type of incidents attended. The Service has determined a provision for lightweight PPE and staff were measured for fitting in April 2019. The project supports the safety and wellbeing of our staff.
- *Pension Liability reserve* – There are ongoing legal cases which may impact on future employers' costs and therefore a pension reserve has been established to contribute towards the revenue budget if a liability arises.
- *National Procurement Project* – The Service has seconded a member of staff to manage the National Procurement Project on behalf of the National Fire Chiefs Council. Grant funding has been received to support the project and is therefore held in a specific reserve until those funds are exhausted.
- *Budget Carry Forwards* – Arise as a result of timing differences, where a revenue project has been unable to complete in year and therefore the under spend on a particular budget line has been transferred to Earmarked Reserves. As reserve funds can span several financial years these are expected to be used in the short term, but the reserve may be enhanced at a later date if there are timing differences in the 2019-20 budget and beyond.
- *Wi-Fi upgrade, Respiratory Protection masks and VEMA outriggers* – These cost pressures were identified as emerging issues as part of the 2018-19 year end process. As these are pressing organisational or operational requirements the reserve funding will be fully utilised in 2019-20.

AMY WEBB
Director of Finance

APPENDIX A TO REPORT RC/19/10

Risk Assessment of the Adequacy of General Reserves

Budget Head	Budget Provision 2019-20 £m	RISK	Likelihood	Impact £m	Net Impact £m
Wholetime Pay Costs	31.2	Wholetime Pay represents nearly a third of Service costs. There is a high level of uncertainty around future pay increases, particularly whether pay awards will be linked to a change to the Firefighter role map to include emergency medical response, which might attract a significant Pay award. An unfunded pay award of 2% has been factored in to the budget for 2019-20.	Medium	0.935	0.467
		Overspend due to supernumerary staff whilst Change Programme is developed - the impact of this has reduced since last year as the majority of these costs are now budgeted	High	0.500	0.375
Retained Pay Costs	14.4	A significant proportion of costs associated with retained pay is directly as a result of the number of calls responded to during the year.	Low	1.442	0.360
		There is a high level of uncertainty around future pay increases, particularly whether pay awards will be linked to a change to the Firefighter role map to include emergency medical response, which might attract a significant Pay award	Medium	0.433	0.216
Major Incident - Belwin		A major incident occurs which qualifies for central government funding under the Belwin Scheme - the first 0.2% of budget, or £0.151m is funded by the Local Authority.	Low	0.151	0.038
Firefighter's Pensions	2.7	The Authority is required to fund the costs associated with ill-health retirements, and the potential costs of retained firefighters joining the scheme. There were fewer retirees than budgeted in 2017-18 which has increased the likelihood of those individuals retiring in 2019-20.	High	0.500	0.375
Insurance Costs	0.9	The Fire Authority's insurance arrangements require the authority to fund claims up to agreed insurance excesses. In addition some uninsured costs such as any compensation claims from Employment Tribunals carry a financial risk to the Authority. The Insurance Mutual holds a reserve which will enable the pool to absorb a reasonable level of claims.	Low	0.500	0.125
Fuel Costs	0.7	As fuel prices are slowly starting to increase it is highly possible that inflationary increases could be in excess of the budget provided.	High	0.182	0.137
Treasury Management Income	(0.2)	Reduced Interest Income, rates to 0%. The target income for 2019-20 has been set at a prudent level of achieving only a 0.6% return on investments.	Low	0.201	0.050
Income	(0.6)	Whilst the authority has only limited ability to generate income, the budget has been set on the basis of delivering £0.6m of external income whilst setting the reliance on the Service budget for Red One Income at £0.3m. Due to economic uncertainty this budget line may be at risk.	Low	0.282	0.071
Capital Programme	8.8	Capital projects are subject to changes due to number of factors; these include unforeseen ground conditions, planning requirements, necessary but unforeseen changes in design, and market forces. The risk of contract deviation up to 10% of value.	Low	0.881	0.220
Business Rates	(0.9)	There is a high degree of uncertainty over levels of Retained Business rates income and the method of allocation between funding and revenue grants in future years.	Low	0.225	0.056
External Contracts		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. The Authority maintains a bad debt provision based on aged debtor analysis but it would be insufficient to fully fund a loss from a major contract. Additionally, Public Sector procurement processes and contracts are coming under increasing scrutiny and could be open to legal challenge.	Low	2.000	0.500

Budget Head	Budget Provision 2019-20 £m	RISK	Likelihood	Impact £m	Net Impact £m
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.	Low	3.000	0.750
System/ Infrastructure Issues		In the event that a key system, such as the control mobilising system or system networks, were to fail, it is possible that urgent consultancy or replacement equipment would be required within short time constraints.	Low	1.500	0.375
Funding Issues		The changes to the funding mechanism for local government, introduced following the Local Government Resource Review, transferred potentially significant levels of financial risk to the Authority.	Medium	1.000	0.500
Inflation		Whilst allowances for inflation have been made within specific budget lines, generally at 2.4% per annum, the uncertainty surrounding Brexit and the UK economy might lead to increased inflation.	Medium	0.200	0.100
Employment Issues		Issues that might arise in respect of pay settlements or other factors which might lead to industrial action would, in the first instance, be managed within the revenue budget. Prolonged Action or issues would require funding from Reserves.	Medium	1.000	0.500
Estimated Reserve Requirement					5.216

APPENDIX B TO REPORT RC/19/10

Projected Reserve Balances over Medium Term Financial Plan Period (2019-24)

	Projected Balance as at 1 April 2019 £000	Projected Spend 2019-20 £000	Proposed Balance as at 31 March 2020 £000	Projected Spend 2021-24 £000	Proposed Balance as at 31 March 2024 £000
RESERVES					
Earmarked reserves					
Grants unapplied from previous years	(1,145)	918	(227)	227	-
Invest to Improve	(5,937)	1,500	(4,437)	4,437	-
Budget Smoothing Reserve	(1,818)	-	(1,818)	1,818	-
Direct Funding to Capital	(19,956)	3,439	(16,517)	10,000	(6,517)
Projects, risks, & budget carry forwards					
PFI Equalisation	(295)	-	(295)	-	(295)
Emergency Services Mobile Communications Programme	(932)	200	(732)	732	-
Breathing Apparatus Replacement	(1,449)	1,449	-	-	-
Mobile Data Terminals Replacement	(381)	381	-	-	-
PPE & Uniform Refresh	(488)	488	-	-	-
Pension Liability reserve	(461)	-	(461)	461	-
National Procurement Project	(90)	45	(45)	45	-
Budget Carry Forwards	(363)	100	(263)	263	-
Upgrade Wi-Fi & Internet Connection	(75)	75	-	-	-
Respiratory Protection Masks - Personal Fit	(70)	70	-	-	-
Vema Outriggers	(95)	95	-	-	-
Total	(33,556)	8,760	(24,796)	17,985	(6,812)
General reserve					
General Fund balance	(5,315)	-	(5,315)	-	(5,315)
Percentage of general reserve compared to net budget					
TOTAL RESERVE BALANCES	(38,870)	8,760	(30,111)	17,985	(12,126)
PROVISIONS					
Doubtful Debt	(650)	-	(650)		
Fire fighters pension schemes	(759)	100	(659)	659	-
TOTAL PROVISIONS	(759)	100	(659)	659	-