

| | |
|----------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| REPORT REFERENCE NO. | RC/21/12 |
| MEETING | RESOURCES COMMITTEE |
| DATE OF MEETING | 9 SEPTEMBER 2021 |
| SUBJECT OF REPORT | RESERVES STRATEGY 2021-22 |
| LEAD OFFICER | Director of Finance and Resourcing (Treasurer) |
| 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 fourth 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 2020-21 |

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 2021-22.

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 will 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 2021-22 funding gap on the Firefighters Pension scheme and any shortfall in council tax receipts.

- 4.3 The Authority has set its prudential Indicator for the General Reserve at around 5% of annual budget which is a commonly used benchmark across the Fire Sector. At the start of 2021-22, the General Reserve slightly exceeded this at 6.8% of the Authority's net revenue budget. 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 in budgets, an emerging risk, 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, 2021-22, 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 £4.7m. At the start of 2021-22 the General Reserve stood at £5.3m 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.
- Grants received in advance*
- 5.2. **£5.24m:** 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.
- 5.3. Any smaller amounts 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 2021-26.

Invest to Improve

- 5.4. **£4.35m:** 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 costs.
- 5.5. The Authority has approved the Safer Together programme and new Service Delivery Operating Model which identified the requirement to invest in improvement activity and the resulting costs and benefits have been fed in to the Medium Term Financial Plan for 2021-22 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, £1.54m is committed to existing projects with the remaining expenditure to be spent over the next three years.

Budget smoothing

- 5.6. **£1.82m:** 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 2021-22 to 2025-26 has identified a potential funding shortfall of £7.2m (base case) which, if not addressed through changes to the way we work, will need to be funded from reserves.
- 5.7. The COVID-19 pandemic has introduced further uncertainty over financial security of all public services, a Spending Review in the autumn of 2021 has now been confirmed. Regardless of central government, the impact of the pandemic in economic terms is likely to be felt for many years, potentially reducing council tax and business rates income. It is therefore forecast that the Budget Smoothing reserve will be exhausted within the Medium Term Financial Planning Period.

Capital Funding

- 5.8. **£23.3m:** 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. Reserves represents an opportunity to reduce borrowing in the future as well as the associated costs.

- 5.9. Borrowing currently stands at £24.8m 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 £6.575m of reserve funding in 2021-22 and for the reserve to be exhausted over the medium term. This level of expenditure is due to the order of a significant upgrade to our fire engine fleet and several major Estates projects which have been formally commissioned.
- 5.10. 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.

Specific projects, budget carry forwards or risks identified

- 5.11. 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. Expenditure on these items will normally be spread over several financial years.
- 5.12. 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.
- 5.13. Explanation of specific reserves:
- **£0.15m: 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.
 - **£0.55m: 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.

- **£0.27m: 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. The project is due to complete in 2021-22.
- **£1.23m: 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.
- **£0.308m: Environmental Strategy** – This new reserve has been established to support the Authority's environmental strategy, assessing the impact of services and seeking to adapt and mitigate to reduce emissions.
- **£3.7m: 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 2020-21 budget and beyond.
- **£0.1m: Lightweight/ female PPE**- 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 this was delivered in late 2019. The project has now moved on to ensuring that appropriate stocks and sizing of female firefighter PPE are maintained. The project supports the safety and wellbeing of our staff.
- **£0.2m: MTA Plan**- Organisational action plan to improve Marauding Terrorist Attack (MTA) capability in line with the National Joint Operating Principles (JOP's)

SHAYNE SCOTT

Director of Finance and Resourcing (Treasurer)

Risk Assessment of the Adequacy of General Reserves

| Budget Head | Budget Provision 2021-22 £m | RISK | Likelihood | Impact £m | Net Impact £m |
|------------------------|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|------------------|
| Service Delivery Staff | 51.8 | Whole-time 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 larger Pay award. An unfunded pay award of 1.5% has been agreed with effect from 1 July which represents an unbudgeted pressure. As such, this risk has now crystallised. | Crystallised | 0.777 | 0.777 |
| Firefighter's Pensions | 2.4 | 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 2020-21 which has increased the likelihood of those individuals retiring in 2021-22. | 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 | Fuel price fluctuation can have a significant impact on fleet running costs. This risk has been increased from medium to high due to anticipated inflation during the COVID-19 recovery period | High | 0.173 | 0.129 |

| Budget Head | Budget Provision 2021-22 £m | RISK | Likelihood | Impact £m | Net Impact £m |
|-----------------------------------|--------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|----------------------|------------------------------|
| Treasury Management Income | (0.1) | Reduced Interest Income. The target income for 2021-22 has been set at a prudent level of achieving £0.1m return on investments. While interest rates are slowly recovering, we are now not expecting to achieve this level of return. Q1 performance has seen us obtain 0.023m return on our investment. This risk remains at a medium likelihood. | Medium | 0.075 | 0.038 |
| Income | (0.8) | Whilst the authority has only limited ability to generate income, the budget has been set on the basis of delivering £0.8m of external income whilst setting the reliance on the Service budget for Red One Ltd. Income at £0.3m. A repayment plan has now been agreed with Red One Ltd. therefore this risk has been reduced from High to Medium. | Medium | 0.415 | 0.208 |
| Capital Programme | 12.6 | 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 has been measured at 10% of proposed spend, although the likelihood remains low given the Authority's robust capital reserves. | Low | 1.260 | 0.315 |
| 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 2021-22 £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% per annum, the uncertainty surrounding Brexit, COVID-19 and the likely surge in UK economic activity will likely lead to increased inflation. This risk has therefore been increased from Low to Medium due to current inflation forecasts for 2021-22 suggesting that inflation may temporarily exceed 3%. | 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 | | | | | 4.7 |

APPENDIX B TO REPORT RC/21/12

Projected Reserve Balances over Medium Term Financial Plan Period (2021-26)

| RESERVES AND PROVISIONS | | | | | |
|------------------------------------------------------|----------------------------|-----------------------------------|-------------------------------------------|----------------------------------------|----------------------------------------------------|
| | Balance as | | Proposed | | Proposed Balance as at 31 March 2026 £000 |
| | at 1 April 2021 £000 | Forecast Spend 2021-22 £000 | Balance as at 31 March 2022 £000 | Projected Spend 2022- 26 £000 | |
| RESERVES | | | | | |
| Earmarked reserves | | | | | |
| Grants unapplied from previous years | (5,244) | 3,335 | (1,909) | 1,909 | - |
| Invest to Improve | (4,133) | 1,516 | (2,616) | 2,616 | - |
| Budget Smoothing Reserve | (1,818) | - | (1,818) | 1,818 | - |
| Direct Funding to Capital | (23,270) | 6,575 | (16,695) | 15,245 | (1,450) |
| Projects, risks, & budget carry forwards | - | - | - | - | - |
| PFI Equalisation | (150) | - | (150) | - | (150) |
| Emergency Services Mobile Communications Programme | (550) | - | (550) | 550 | - |
| Mobile Data Terminals Replacement | (266) | 266 | (0) | 0 | - |
| Pension Liability reserve | (1,231) | 1,231 | (0) | 0 | - |
| Environmental Strategy | (308) | 100 | (208) | 208 | - |
| Budget Carry Forwards | (3,459) | 1,179 | (2,280) | 2,280 | - |
| Performance Info System | (230) | - | (230) | 230 | - |
| Lightweight/female PPE | (100) | - | (100) | 100 | - |
| Uncategorised | (231) | 23 | (208) | 208 | - |
| MTA Action Plan | (200) | 200 | 0 | - | - |
| Total earmarked reserves | (41,189) | 14,425 | (26,765) | 25,165 | (1,600) |
| General reserve | | | | | |
| General Fund (non Earmarked) Balance | (5,282) | - | (5,282) | - | (5,282) |
| Percentage of general reserve compared to net budget | | | | | |
| TOTAL RESERVE BALANCES | (46,472) | 14,425 | (32,047) | 25,165 | (6,882) |
| PROVISIONS | | | | | |
| Doubtful Debt | (655) | - | (655) | | (655) |
| Fire fighters pension schemes | (659) | | (659) | 659 | - |
| TOTAL PROVISIONS | (1,314) | - | (1,314) | 659 | (655) |