LANCASHIRE COMBINED FIRE AUTHORITY
Meeting to be held on 19th February 2018

RESERVES AND BALANCES POLICY
(Appendix 1 refers)

Contact for further information:
Keith Mattinson - Director of Corporate Services – Telephone Number 01772 866804

Executive Summary

The Fire Authority needs to hold reserves to meet potential future expenditure requirements.

The reserves policy is based on guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

The policy explains the difference between general reserves (those held to meet unforeseen circumstances) earmarked reserves (those held for a specific purpose) and provisions (where a liability exists but the extent and/or timing of this is uncertain). In addition, the policy identifies how the Authority determined the appropriate level of reserves and what these are.

The policy confirms that the level of and the appropriateness of reserves will be reported on as part of the annual budget setting process and as part of the year end accounting process.

The most significant issues are:-

- General reserves are sufficient for next 2-3 years, but will run out unless additional funding is provided or the budget requirement reduces due to changing assumptions/reduction in recruitment or other savings identified;
- No allowance for potential SHQ relocation, resulting in the Authority holding £1.4m of capital reserves at 31 March 2023;
- A fundamental review of all earmarked reserves and provisions has been undertaken, removing several small reserves, reinstating the Debt repayment reserve and creating a new innovations reserve.

Recommendation

The Authority is requested to approve the policy and note the Treasurer's advice on the level of reserves included within it.

Reserves and Balances Policy

The draft National Framework published in December includes a section on reserves. The main components of which are:-

- General reserves should be held by the fire and rescue authority and managed to balance funding and spending priorities and to manage risks. This should be established as part of the medium-term financial planning process.
- Each fire and rescue authority should publish their reserves strategy on their website. The reserves strategy should include details of current and future

planned reserve levels, setting out a total amount of reserves and the amount of each specific reserve that is held for each year. The reserves strategy should provide information for at least two years ahead.
- Sufficient information should be provided to enable understanding of the purpose for which each reserve is held and how holding each reserve supports the fire and rescue authority's medium term financial plan.
- Information should be set out in a way that is clear and understandable for members of the public, and should include:
  - how the level of the general reserve has been set;
  - justification for holding a general reserve larger than five percent of budget;
  - whether the funds in each earmarked reserve are legally or contractually committed, and if so what amount is so committed; and
  - a summary of what activities or items will be funded by each earmarked reserve, and how these support the fire and rescue authority's strategy to deliver good quality services to the public.

As such this year's reserves policy has been amended to reflect these draft requirements.

General Reserves

These are non-specific reserves which are kept to meet short/medium term unforeseeable expenditure and to enable significant changes in resources or expenditure to be properly managed in the medium term.

The Authority needs to hold an adequate level of general reserves in order to provide:-

- A working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing;
- A contingency to cushion the impact of unexpected events;
- A means of smoothing out large fluctuations in spending requirements and/or funding available.

The following table sets out the purpose of this reserve, how it is utilised, controlled and reviewed.

Name	General Fund
Purpose	This covers uncertainties in future years budgets, such as: • future grant settlements being lower than forecast; • higher levels of inflation than budgeted; • increasing cost of and changes to pensions; • service demands increasing, putting additional pressure on demand led budgets; • changes in legislation impacting on future service provision; • potential cost of industrial action.
Utilisation	This is utilised to offset any in-year overspend that would occur when comparing budget requirement to the level of funding generated.

Controls	The utilisation of this is agreed as part of the annual budget setting process. Any further utilisation requires the approval of the Resources Committee.
Review	The adequacy of this is reviewed annually, as part of the budget setting process.

Review of Level of Reserves

In determining the appropriate level of general reserves required by the Authority, the Treasurer is required to form a professional judgement on this, taking account of the strategic, operational and financial risk facing the Authority. This is completed based on guidance issued by CIPFA, and includes an assessment of the financial assumptions underpinning the budget, the adequacy of insurance arrangements and consideration of the Authority's financial management arrangements. In addition the assessment should focus on both medium and long-term requirements, taking account of the Medium Term Financial Strategy (as set out in the draft budget report elsewhere on this agenda).

For Lancashire Combined Fire Authority this covers issues such as: uncertainty surrounding future funding settlements and the potential impact of this on the revenue and capital budget; uncertainty surrounding future pay awards and inflation rates; the impact of changes to pension schemes; demand led pressures; risk of default associated with our investments as set out in the Treasury Management Strategy, cost associated with maintaining operational cover in the event of Industrial Action etc.

The draft Local Government Finance Settlement for 2018/19 maintained the current four year settlement, hence barring exceptional circumstances, the Government expects these amounts to be presented to Parliament each year, up to 2019/20. This provides much greater certainty. However it should be noted that there are only two years of the current multi-year settlement remaining before the Government aims to implement greater business rates retention and the fair funding review of relative needs and resources. The actual details, and hence impact of these are still unknown. Furthermore the impact of Brexit on the national economy is still unknown. Therefore there is still a considerable degree of uncertainty over longer term funding.

However given the continuation of the four year settlement the Treasurer considers it prudent to set the minimum target reserves level at £2.5m, 4.5% of the 2018/19 net revenue budget, as the budget has been adjusted to allow for 2% pay awards and reflects the final Local Government Finance Settlement 2018/19. This is broadly in line with the 5% threshold identified by the Home Office above which the Authority is required to justify why it holds the level of reserves.

Should reserves fall below this minimum level the following financial year's budget will contain options for increasing reserves back up to this level. (Note, this may take several years to achieve.)

Whilst this exercise sets a minimum level of reserves it does not consider what, if any, maximum level of reserves is appropriate. In order to do this the level of reserves held should be compared with the opportunity cost of holding these, which in simple terms means that if you hold reserves that are too high you are foregoing the opportunity to lower council tax or invest in further service improvements.

However, given the limited scope to increase council tax without holding a local referendum the ability to restore depleted reserves in future years is severely limited.

Hence any maximum reserve limit must take account of future anticipated financial pressures and must look at the long term impact of these on the budget and hence the reserve requirement. Based on professional judgement, the Treasurer feels that this should be maintained at £10.0m.

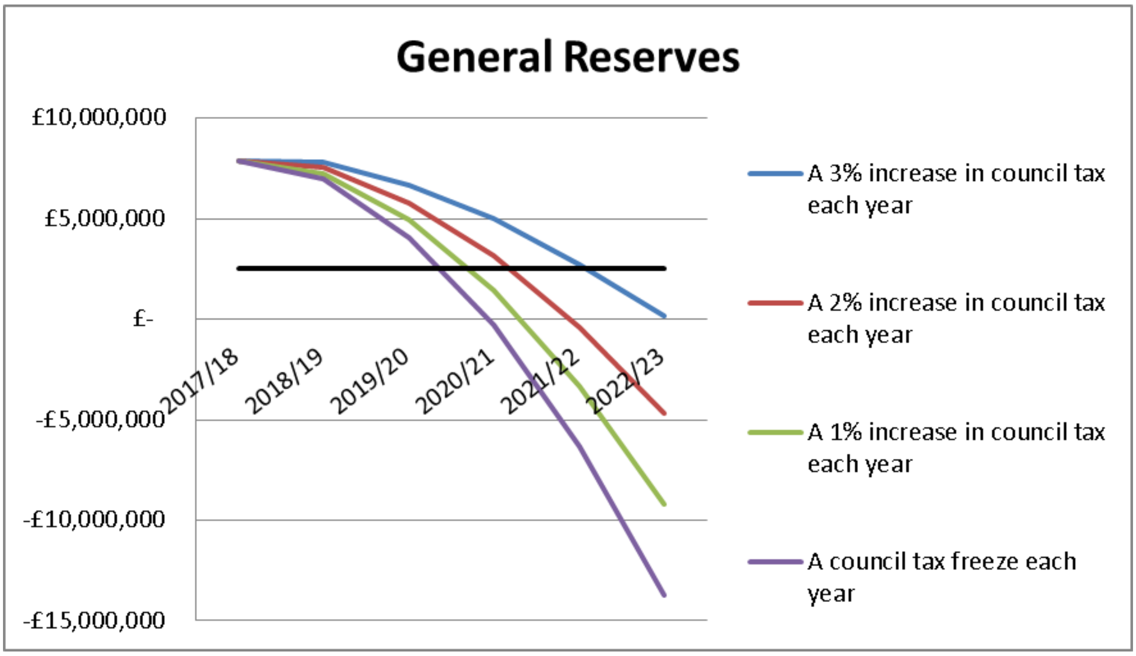
Should this be exceeded the following financial year's budget will contain options for applying the excess balance in the medium term, i.e. over 3-5 years.

Level of General Reserves
The overall level of the general fund balance, i.e. uncommitted reserves, anticipated at the 31 March 2018 is £7.8m, providing scope to utilise approx. £5.3m of reserves.

Based on current assumptions (allowing for a 2% pay award in 2017/18, 2018/19 and 2019/20), and assuming council tax is increased by 3% each year, further drawdowns of £1.2m will be required to balance the revenue budget over the next 2 years, i.e. the remainder of the multi-year settlement. This would reduce our overall general reserve level to £6.6m at 31 March 2020, still within our target range. Based on this the Treasurer considers these are at an appropriate level to meet future expenditure requirements in 2018/19 and 2019/20.

It should be noted that reserves are being used to fund recurring expenditure and hence this can only be a short term solution, with recurring savings being required in the longer term to offset the shortfall.

Thereafter the position is less clear as multi-year settlements will have ended and the budget forecasts become less accurate as there are a whole host of assumptions underpinning these projections, particularly around funding, vacancy profiles, pension costs, future inflation and pay awards and council tax increases. The following graph showing the point at which general reserves dip below minimum requirements, and the point at which they are exhausted, based on various council tax options.



The graph shows that even allowing for a 3% council tax increase the level of general reserve at the end of March 2020 will be £2.7m, marginally above our minimum level, but will fall to below this the following year. Hence over the medium term the general reserve will potentially fall below the 5% threshold identified by the Home Office.

Earmarked Reserves

These are reserves created for specific purposes to meet known or anticipated future liabilities and as such are not available to meet other budget pressures. They can only be used for that specific purpose, for which they were established, and as such it is not appropriate to set any specific limits on their level, but as part of the annual accounts process their adequacy will be reviewed and reported on.

The following table sets out the purpose of this reserve, how it is utilised, controlled and reviewed.

Name	Earmarked
Purpose	This covers monies set aside for specific purposes.
Utilisation	Once set up these reserves can only be used for the specific purpose for which they were established.
Controls	The utilisation of these are discussed at quarterly DFM meetings between the budget holder, relevant Executive Board member, and the Director of Corporate Services.
Review	The level of earmarked reserves is reviewed each year as part of the revenue outturn/annual accounts process to ensure these are reasonable and remain relevant.

The Director of Corporate Services has delegated authority to create new earmarked reserves valued at up to £100,000; any request which exceeds this must be reported to the Resources Committee for approval.

Specific earmarked reserves will be closed when there is no longer a requirement to hold them, at which point they will either hold a nil balance or when any outstanding balance will be transferred into the general reserve.

<u>Level of Earmarked Reserves</u>
The following table provides a breakdown of the £7.4m of earmarked reserves forecast to be held at 31st March 2018, and a forecast of the anticipated position as at 31 March 2023:-

	Balance Forecast at 31 March 2018	Balance Forecast at 31 March 2023	
	£m	£m	
DFM Reserve	0.3	0.3	Devolved Financial Management Reserve enables budget holders to carry forward any surplus or deficit from one financial year to the next, within prescribed limits. The Service has strong financial management ethos and hence has a track record of managing within individual budget allocations,

			hence has not previously utilise these reserves to a large degree. However as the Service comes under increasing pressure and departmental budgets are squeezed this provides greater flexibility to individual budget holder and optimises the use of resources. Examples of areas where these balances have been used previously would be one off replacements of equipment, or enhancement to station facilities etc. The levels of individual DFM reserves are reviewed each year as part of the revenue outturn/annual accounts process, to ensure that they are reasonable and that budget holders are not building up excessive reserves. The latest such review has identified a reduction of £0.1m in 2017/18 which has been used to contribute to the innovation fund referred to later in this report. At present there are no contractual or legal obligations against this reserve, as any such commitments would be included in the base revenue budget.
PFI Reserves	4.3	4.0	Private Finance Initiative Reserve, which is used to smooth out the annual net cost to the Authority of the existing PFI scheme, and will be required to meet future contract payments. The utilisation of this is set out in the budget agreed at the start of the year, any variance in requirements from this are agreed by the Treasurer as part of the revenue outturn/annual accounts process. The level of reserve required to meet future contract payments has been updated to reflect inflation levels. Inflation in both PFI schemes is based on RPI, which is typically 1% higher than CPI and which is currently running in excess of 4%. As such next year's contract increase has been updated to reflect this, with future years based on a 3% increase (this is based on both historic data and the 2.0% Bank of England CPI target adjusted to RPI). This results in an increase of £0.7m in 2017/18 which has been met by reducing the insurance reserve/provision outlined later in the report, reflecting the Authority's excellent claims history. Assuming CPI continues at 3% the whole of this reserve is contractually committed over the next 20 years.

Insurance Aggregate Stop Loss (ASL)	1.1	1.1	The Authority has aggregate stop losses (ASLs) on both its combined liability insurance policy (£0.4m) and its motor policy (£0.3m). This means that in any one year the Authority's maximum liability for insurance claims is capped at the ASL. As such the Authority can either meet these costs direct from its revenue budget or can set up an earmarked reserve to meet these. Within Lancashire we have chosen to meet the potential costs through a combination of the two. Hence the amount included in the revenue budget reflects charges in a typical year, with the reserve being set up to cover any excess over and above this. As such the reserve, combined with amounts within the revenue budget, provides sufficient cover to meet 2 years' worth of the maximum possible claims, i.e. the ASL (previously this allowed for 3 years' worth of cover but given our excellent claims history we have adjusted this downwards). It is worth noting that the revenue budget allocation has also been reduced in recent years reflecting the claims history. Without holding this reserve to cushion any major claims that may arise this would not have been possible. None of this reserve is legally committed at the present time, although as soon as a significant claim arose this position would change.
PWLB Loan repayment penalty	0.9	0.9	This reserve was created to meet the potential penalty costs associated with repayment of the remaining PWLB loans. £0.6m was used to meet the penalty costs associated with the early repayment of £3.2m of loans, as agreed at Resources Committee. The Authority still has £2.0m of long term loans, maturing between 2035 and 2037, as set out in the Treasury Management Strategy reported elsewhere on this agenda, and currently incurs £0.1m of interest charges on these loans. We continue to review opportunities to repay these, hence saving any interest payments, however based on the current penalty associated with this, £0.9m, it is not considered prudent to do so at the present time. Members agreed this position in December 2017 but wished to review this in light of any further development relating to the potential relocation of Service Headquarters. As such

			the reserve has been topped up in order to provide sufficient scope to meet any penalty costs should the Authority decide to repay these loans. There is no legal or contractual commitment against this reserve. It is worth noting that this is a notional amount as any penalties incurred will depend on both forecast interest rates and the remaining time to maturity, hence the actual penalty will be considered as part of the decision to repay the loans in due course, with any such decision being considered as part of future Treasury Management Strategy. Should Members decide to relocate SHQ, and hence agree to maintain the existing loans until maturity, the reserve could be used to offset some of the capital costs associated with the relocation.
Prince's Trust	0.2	0.2	This reserve has been established to balance short term funding timing differences and also to mitigate the risk of loss of funding and enable short term continuation of team activities, whilst alternative funding is found. The reserve is equivalent to 25% of the Teams current external funding target. Without this reserve any significant loss of funding would have an immediate impact on our ability to deliver the PT programme, and hence improve the lives of younger people. There are no legal or contractual commitments against this.
ESMCP Ring-fenced Funding	0.1	-	As part of the Emergency Services Mobile Communication Programme (ESMCP), transitional funding was made available to fund costs associated with the transition to the new national arrangements, with any funds not spent in 2016/17 being carried forwards for use in future years. Whilst there are no contractual or legal commitments against this at the present time, the on-going programme will require this funding to be utilised in the new financial year
Apprentices	0.1	-	This reserve was created from the in-year underspend relating to the appointment of apprentices, which was delayed awaiting national developments. As such the reserve has been set up to offset some of the pay costs that will be incurred in 2018/19, with the balance being met direct from the revenue budget. Hence the entire reserve is contractually committed in meeting pay costs associated with apprentices

			appointed in the current financial year. This clearly contributes to addressing apprenticeship targets, set by the Government, as well as addressing capacity issues within departments.
Innovation Fund	0.5	0.5	The Authority has previously created a Future Fire Fighting capital budget which has been used to meet costs arising from innovation within the sector, most notably the introduction of Technical Rescue Jackets. This capital budget will have been fully utilised in 2017/18. Given the fact that current replacement priorities are already included in the revenue budget we have not built any allowance into the capital programme for a continuation of this. However it is inevitable that developments will occur and we will continue to evaluate these with a view to introducing those that improve service delivery or fire fighter safety. As such it is proposed to establish an innovation fund to cover any such developments, with any requests to utilise the fund requiring the approval of the Executive Board. None of this reserve is contractually or legally committed at the present time.
	7.4	**6.9**	

It is worth noting that of the anticipated balance of £6.9m at 31 March 2023 over half of this relates to the PFI reserve.

Based on this the Treasurer believes these are adequate to meet future requirements in the medium term.

Capital Reserves and Receipts

Capital Reserves have been created from under spends on the revenue budget in order to provide additional funding to support the capital programme in future years; as such they cannot be used to offset any deficit on the revenue budget, without having a significant impact on the level of capital programme that the Authority can support.

Capital Receipts are generated from the sale of surplus assets, which have not yet been utilised to fund the capital programme. Under revised regulations receipts generated between April 2016 and March 2019 can be used to meet qualifying revenue costs, i.e. set up and implementation costs of projects/schemes which are forecast to generate on-going savings. The on-going costs of such projects/schemes do not qualify. Whilst the Authority currently holds £1.6m of capital receipts only £70k of this arose in the relevant time period. Given the small amount eligible we do not currently have any plans to use this in line with new regulations and hence for the purpose of planning all capital receipts will be used to meet future capital costs, not qualifying revenue expenditure.

The following table sets out the purpose of this reserve, how it is utilised, controlled and reviewed.

Name	Capital reserves and receipts
Purpose	This covers monies set aside to fund the future capital programme.
Utilisation	Once set up these reserves can only be used to fund capital expenditure
Controls	The proposed utilisation of these is reported to the Authority as part of the capital programme setting and monitoring arrangements.
Review	These are reviewed on an annual basis as part of the year end outturn, reported to Resources Committee and as part of the capital budget setting report to the Authority.

At 31 March 2018 the Authority anticipates holding £19.0m of capital reserves and receipts. We anticipate utilising £6.7m of this in respect of slippage from the 2017/18 capital programme; the most significant element of which relates to Preston Fire station where we have been pursuing a joint Fire and Ambulance station but progress on agreeing this has been slow. Within this figure £0.6m is already contractually committed. Based on the capital programme presented elsewhere on this agenda we anticipate utilising a further £10.9m by 31 March 2023, £1.7m of which is already contractually committed. This leaves a balance of £1.4m to fund future capital programmes.

Based on this the Treasurer believes these are adequate to meet future requirements in the medium term.

It should be noted that no allowance has been built in the capital programme for the potential relocation of SHQ. If this was included in the 5 year capital programme then all capital reserves and receipts would be utilised to fund this, as well as potentially requiring additional borrowing.

Provisions

The Authority has two provisions to meet future estimated liabilities:-

<u>Insurance Provision</u>
This covers potential liabilities associated with outstanding insurance claims. Any claims for which we have been notified and where we are at fault will result in a legal commitment, however as the extent of these cannot be accurately assessed at the present time this provision is created to meet any element of cost for which we are liable, i.e. which are not reimbursable from insurers as they fall below individual excess clauses and the annual self-insured limits. This provision fully covers all estimated costs associated with outstanding claims.

The following table sets out the purpose of this provision, how it is utilised, controlled and reviewed.

Name	Insurance Provision
Purpose	This covers monies set aside to meet future insurance claims.
Utilisation	Once set up the provision can only be utilised to meet insurance claims.
Controls	The utilisation of these are reported on an annual basis as part of the year end outturn report presented to Resources Committee.
Review	The level of the provision is reviewed annually based on existing and anticipated outstanding insurance claims to ensure these are reasonable and remain relevant.

A fundamental review of current claims outstanding and our claims history has been undertaken and as such the provision will be reduced to £0.4m at 31 March 2018. However this will be subject to further review as part of the annual year end process, reflecting the settlement of outstanding claims as well as all outstanding claims that we have been notified of or which may arise as at 31 March 2018.

Business Rates Collection Fund Appeals Provision

This covers the Authority's share of outstanding appeals against business rates collection funds, which is calculated each year end by each billing authority within Lancashire based on their assumptions of outstanding appeal success rates, as part of their year-end accounting for the business rates collection fund.

The following table sets out the purpose of this provision, how it is utilised, controlled and reviewed.

Name	Business Rates Collection Fund Appeals Provision
Purpose	This covers monies set aside to meet the Authority's share of the cost of successful business rates appeals.
Utilisation	Once set up the provision can only be utilised to meet costs associated with settlement of such appeals.
Controls	The utilisation of these are reported on an annual basis as part of the year end outturn report presented to Resources Committee.
Review	The level of the provision is reviewed annually based on each billing authority's assumptions regarding success rates to ensure these are reasonable and remain relevant.

At 31 March 2017 this provision stood at £0.7m to cover anticipated costs of outstanding business rates appeals. Whilst a significant element of this will be utilised in the current financial year, reflecting the settlement of outstanding appeals, it is impossible to accurately predict the extent of this usage or the need for any additional provision to meet appeals that arise in year, until such time as a full review is undertaken as part of the financial year end process. Therefore for the purpose of this report we have assumed that the level of business rates appeals provision remains unchanged.

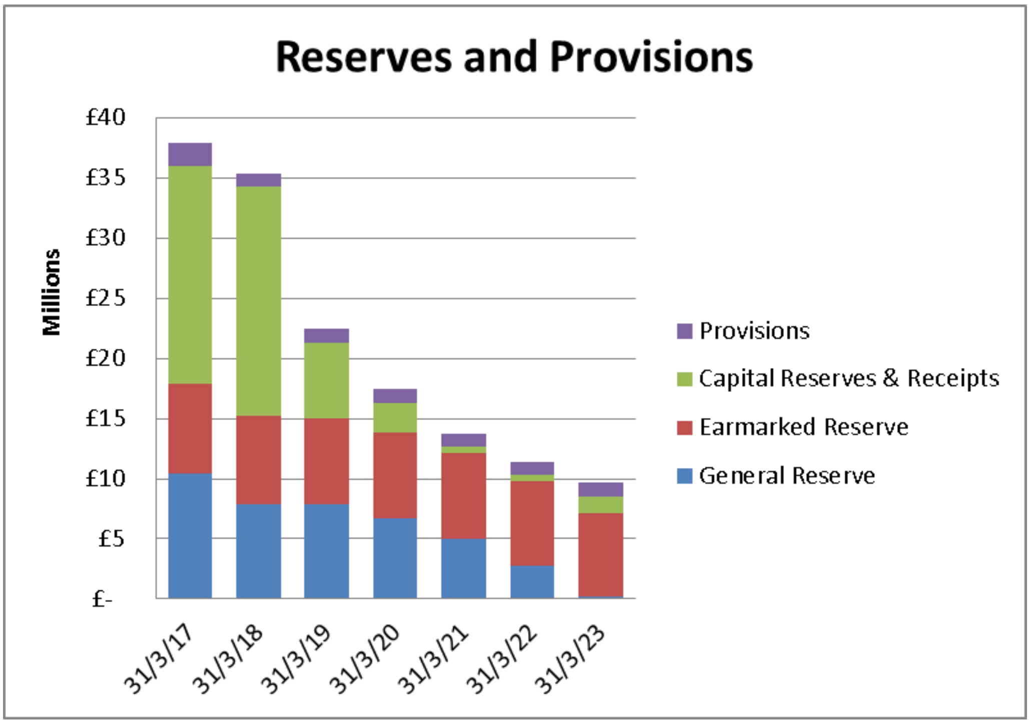
Until the outcome of any appeal is known there is no legal obligation arising from the appeal.

The Treasurer feels that the level of provisions are sufficient to meet future requirements in the medium term.

Summary Reserve Position

The following table sets out the summary anticipated position in terms of reserves and balances showing the overall level reducing to approx. £17m by 31 March 2020 the end of the current four year settlement period, and reducing down to £8m by March 2023 (further details are provided in Appendix 1):-

	General Reserve	Earmarked Reserve	Capital Reserves & Receipts	Provisions	Total Reserves & Balances
	£m	£m	£m	£m	£m
Balance 31/3/17	10.4	7.5	18.1	1.9	37.9
Change in year	(2.6)	(0.0)	0.9	(0.7)	(2.5)
Balance 31/3/18	7.8	7.4	19.0	1.1	35.4
Change in year	0.0	(0.2)	(12.7)	0.0	(13.0)
Balance 31/3/19	7.8	7.2	6.3	1.1	22.4
Change in year	(1.2)	(0.0)	(3.8)	0.0	(5.0)
Balance 31/3/20	6.7	7.1	2.5	1.1	17.4
Change in year	(1.7)	(0.1)	(1.9)	0.0	(3.7)
Balance 31/3/21	5.0	7.1	0.6	1.1	13.8
Change in year	(2.3)	(0.1)	(0.0)	0.0	(2.3)
Balance 31/3/22	2.8	7.0	0.5	1.1	11.4
Change in year	(2.6)	(0.1)	0.9	0.0	(1.8)
Balance 31/3/23	0.2	6.9	1.4	1.1	9.6



As this shows up to 31/3/2020, the end of the current multi-year settlement period, we remain in a healthy position. The reduction in the level of reserves becomes more of a concern thereafter with general reserves potentially falling below the minimum target level, but this position will be subject to significant change as funding, inflation, pay awards and other pressures all become clearer in future years. The annual refresh of this policy will identify the impact of any changes as they develop.

For comparative purposes the average level of reserves relative to total revenue expenditure across all Fire Authorities as at 31 March 2017 was 44%. Our anticipated position at the end of the current financial year shows reserves equal to 64% our revenue expenditure. However within this are £7m of capital slippage and a further £4m of PFI reserve, if we exclude these total reserves equate to £24m, 44% of our total revenue expenditure which is in line with the sector average. Not only that the draft capital programme shows a significant proportion of reserves being used in the next 2 years, reducing this figure down to approx. 30% by March 2020 (24% if we exclude the PFI reserve).

It is also worth noting the comparator with other types of Authorities as set out in the Revenue Outturn Summary for 2016/17 comparing Net Revenue Expenditure with Non School Reserves:-

• London Boroughs	47%
• Metropolitan Districts	36%
• Unitary Authorities	37%
• Shire Counties	26%
• Shire Districts	138%
• Other (which includes Fire)	47%
• Overall	39%

Financial Risk

There is a risk that the level of reserves will not be sufficient to meet future requirements, this policy and the subsequent reporting mechanism is designed to mitigate this.

HR Risk

None.

Equality and Diversity Implications

None.

Environmental Impact

None.

Business Risk Implications

The management of reserves forms a key element of our budget strategy. Having an agreed policy, within which we are able to manage our reserves, provides clearer accountability, and reduces the risk of the Authority maintaining an inappropriate level of reserves, either too high or too low.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	**Date**	**Contact**
CIPFA Guidance	Various	Keith Mattinson
Local Government Finance settlement	December 2017 & February 2018	Keith Mattinson
Revenue, Capital Budget and Treasury Management Strategy Reports to CFA	December 2017 & February 2018	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		

Appendix 1

	31/3/18	31/3/19	31/3/20	31/3/21	31/3/22	31/3/23
General	**7.8**	**7.8**	**6.7**	**5.0**	**2.8**	**0.2**
Earmarked						
DFM	0.2	0.2	0.3	0.3	0.3	0.3
PFI	4.3	4.3	4.2	4.2	4.1	4.0
Insurance ASL	1.1	1.1	1.1	1.1	1.1	1.1
PWLB Loan Penalty	0.9	0.9	0.9	0.9	0.9	0.9
Princes Trust	0.2	0.2	0.2	0.2	0.2	0.2
ESMCP	0.1	-	-	-	-	-
Apprentices	0.1	-	-	-	-	-
Innovation Fund	0.5	0.5	0.5	0.5	0.5	0.5
	7.4	**7.2**	**7.1**	**7.1**	**7.0**	**6.9**
Capital Reserves & Receipts	**19.0**	**6.3**	**2.5**	**0.6**	**0.5**	**1.4**
Provisions						
Insurance	0.4	0.4	0.4	0.4	0.4	0.4
Business Rate Collection Fund Appeals	0.7	0.7	0.7	0.7	0.7	0.7
	1.1	**1.1**	**1.1**	**1.1**	**1.1**	**1.1**
	35.4	**22.4**	**17.4**	**13.8**	**11.4**	**9.6**