LANCASHIRE COMBINED FIRE AUTHORITY
Meeting to be held on 21 February 2022

RESERVES AND BALANCES POLICY 2022/23
(Appendix 1 refers)

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Table 1 Executive Summary and Recommendations

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 determines 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 to meet current requirements. However, there is a great deal of uncertainty as to the level of costs, and who will bear these, relating to changes to the FF pension scheme.
- Earmarked reserves will reduce over the 5-year period, with the PFI reserve accounting for the majority of them.
- Capital reserves will be fully utilised over the 5-year programme.
- Provisions will remain at broadly the same level.

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 National Framework 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.

The reserves policy complies with these requirements.

General Reserves (General Fund)

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 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.

Table 2 Summary of General Reserves (General Fund)

Name	General Reserves (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 and the remedy for the McCloud judgement; 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.

There remains a great deal of uncertainty over long term funding than in recent years as the impact of both Brexit and the Pandemic on public finances and the national economy are still unknown. As a result, the anticipated multi-year settlement has been postponed again, hence the draft settlement only covers 22/23. As a result of the Local Government Finance Settlement the Authority will receive a 1.1% inflationary increase for 2022/23.

Furthermore, the outcome of the fair funding review of relative needs and resources and the Government intention to move to greater retention of Business Rates have also been postponed, and hence are likely to take effect over the next settlement period, which we are anticipating will be a multi-year settlement.

The position in terms of pension costs is also extremely uncertain with guidance relating to Immediate Detriment being issued, and subsequently withdrawn and with there being no clear decision as to where the costs of implementing this will fall.

As such the Treasurer considers it prudent to increase the minimum target reserves level to £4.0m, 6.5% of the 2022/23 net revenue budget, reflecting the increasing level of uncertainty. This is slightly higher than the 5% threshold identified by the Home Office above which the Authority is required to justify why it holds the level of reserves, reflecting the increasing uncertainty about future funding, pension costs and pay awards.

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.

Whilst the settlement provides greater flexibility to increase council tax in 22/23, this is a one-off relaxation of the referendum principles and will not be repeated in future years. Hence the scope to increase council tax in future years to restore depleted reserves is limited, without holding a local referendum. Therefore, 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 2022 is £6.0m, providing scope to utilise approx. £2.0m of reserves.

The draft budget as presented elsewhere on the agenda does not require any drawdown of reserves in 22/23. The Treasurer therefore considers this reserve is at an appropriate level.

Looking at the medium term the need to drawdown reserves will be affected by:-

- Council tax – The revenue budget assumes that council tax is increased by the maximum permissible each year, enabling the Service to deliver a balanced budget each year. If this is not the case, then we may need to utilise reserves in future years to balance the budget.
- Emergency Cover Review (ECR) - The revenue budget assumes that the outcome of the ECR is cost neutral. If this was not the case and the ECR/cessation of DCP required significant investment, then we would need to utilise reserves to fund this
- Pension costs – the revenue budget assumes that the only pension costs that fall on the Service are employer contributions, and that all other costs are met by the Government via the Pension Holding Account. If this is not the case, then reserves would be required to meet these one-off costs which will be very significant
- Future funding - The revenue budget assumes future funding increases by 1% each year, in line with this year’s settlement. If that is not the case and it is frozen, this would reduce funding levels by £0.3m, if that was the case for 4

years the cumulative effect would be a £1m reduction in overall funding, which may impact on the need to drawdown reserves

- Future inflation - The revenue budget assumes future inflation, including pay awards, returns to the Government’s 2% target. If this is not the case each 1% more than this increases the recurring budget requirement by £0.5m, ie £2.5m over the next 5 years, which may impact on the usage of reserves

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.

Table 3 Summary of Earmarked Reserve

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 £9.3m of earmarked reserves forecast to be held at 31st March 2022, and a forecast of the anticipated position as at 31 March 2027: -

Table 4 Earmarked Reserve Balances

	Forecast at 31 March 2022	Forecast at 31 March 2027	
	£m	£m	
Section 21 Business Rate Relief Grant	1.1	-	Last year the Government provided Section 31 Rate Relief grant to individual billing authorities, to cover the additional in-year reliefs provided because of the pandemic. Business rates are split between the Government, billing authorities, Lancashire County Council and ourselves, we receive 1% of the total. As such this grant should be split in line with business rates. However, the Govt allocated all of this to billing authorities to aid cash flow, with the correct distribution anticipated in 21/22, once the outturn business rates position has been agreed. As such we accrued for our anticipated share of this in 20/21 but needed to carry this forward via this reserve to meet the business rate collection fund shortfall that has arisen due to these additional reliefs. Whilst this has been fully utilised in 21/22 the exercise has been repeated and hence a balance of £1.1m needs to be carried forward to meet the collection fund deficit in 22/23 This will be fully utilised in the new financial year.
C/Fwd Underspend Relating to Timing of Activities	0.3	-	Within the revenue budget there were several items that were delayed by the pandemic, and which therefore needed funding carried forward from 20/21 to 21/22. These related to areas such as fire safety, training provision, property maintenance, organisational development and Digital transformation, and are purely a timing issue. We have utilised some of these funds in the current financial years, we have reviewed the need and timing of remaining items, with £0.3m transferring into the capital reserve. This leaves a balance of £0.3m which will be utilised over the next 2 years. There are no contractual or legal obligations against this reserve.
Specific Grant C/Fwd.	0.1	-	This reserve carries forward unspent specific grants provided in 20/21 in respect of • Protection Uplift Grant

			• Building Risk Review Grant • Grenfell Infrastructure Grant • ESMCP Grant We anticipated utilising the majority of these in the current financial year with any balance being utilised next year. There are no contractual or legal obligations against this reserve
Covid Funding	-	-	This reserve carried forward the balance of Covid funding provided by the Government which had not bene utilised by 31 March 2021. This has been fully utilised in the current financial year.
DFM Reserve	0.2	0.2	Devolved Financial Management Reserve enables budget holders to carry forward any surplus or deficit from one financial year to the next, within prescribed limits. This reserve provides greater flexibility to individual budget holder to carry forward underspends within their own budget area to meet future costs and optimise 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. As a result of this exercise we have stripped out £0.1m and transferred this into the capital funding reserve (referred to later in the 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	5.2	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 budget setting/revenue outturn/annual accounts processes.

			The inflationary impact on these schemes is recalculated each year , based on March's RPI. Whilst this exercise has not taken place yet RPI is at its highest level for many years and is significantly above the 3% allowance built into the PFI model. As such we have adjusted the model to allow for a 5% increase in 22/23, which results in a £0.5m increase in the reserve requirement. (Note a further adjustment will be required if the eventual inflationary impact is higher than this). The reduction of this reserve in subsequent years reflecting its drawdown to offset future charges. Assuming RPI returns to 3% in future years 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. (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 claim arose this position would change.
Prince's Trust	0.5	0.5	This reserve has been established to balance short term funding timing differences and to mitigate the risk of loss of funding and enable short term continuation of team activities, whilst alternative funding is found.

			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. This reserve has been capped at £0.5m. There are no legal or contractual commitments against this, however forecasts show this budget reducing reflecting the uncertainty over future funding
Apprentices	0.1	-	This reserve was created from previous in-year underspends relating to the appointment of apprentices, which was delayed awaiting national developments. As such the reserve was set up to offset some of the pay/training costs that will be incurred in future years, with the balance being met direct from the revenue budget. This clearly contributes to addressing apprenticeship targets, set by the Government, as well as addressing capacity issues within departments. There are no contractual commitments against this.
Fleet & Equipment	0.2	-	This reserve was created to meet the cost of replacement projects which were not completed by year end. We anticipate fully utilising this in 22/23 to contribute towards the cost of intruding wildfire PPE across the Service. There are no contractual or legal commitments against this at the present time.
Innovation Fund	0.5	0.2	The Authority created an Innovations Fund to meet costs arising from new initiatives/developments which improve service delivery or fire fighter safety but which are not included in the capital programme. Any requests to utilise the fund require the approval of the Executive Board. The capital program shows £0.25m of this being utilised in 23/24 to fund the provision of a second Vehicle Mounted Data Systems (VMDS) unit in each fire appliances, thus enhancing the capabilities of crews whilst mobile. If the opportunity arises this will be topped up from future savings. None of this reserve is contractually or legally committed at the present time.
	9.3	**6.1**	

It is worth noting that of the anticipated balance of £6.1m at 31 March 2027, £4.0m (66%) 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 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 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 2020 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 £1.7m of capital receipts only £0.2m of this arose in the relevant 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.

Table 5 Summary of Capital Reserves and Receipts

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 2022 the Authority anticipates holding £18.4m of capital reserves and receipts, after allowing for the transfer of £0.4m of earmarked reserves and £0.4m of the year end revenue underspend. Based on the capital programme presented elsewhere on this agenda we anticipate fully utilising these by 31 March 2025. Of the total reserve £1.5m is contractually committed.

Based on this the Treasurer believes these are adequate to meet future requirements in the short to medium term, but recognises that they will be exhausted March 2025.

Provisions

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

Insurance Provision
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.

Table 6 Summary of Insurance Provision

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.

This provision stood at £0.5m at 31 March 2021. Given the uncertainty in terms of future insurance claims we have assumed that the provision will be maintained at this level throughout the 5-year period. There are no existing legal obligations associated with this provision, as the legal obligation only arises when settlement of outstanding claims is agreed.

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.

Table 7 Summary of Business Rates Collection Fund Appeals Provision

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 2021 this provision stood at £1.1m 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 by billing authorities 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 levels of provisions are sufficient to meet future requirements in the medium term.

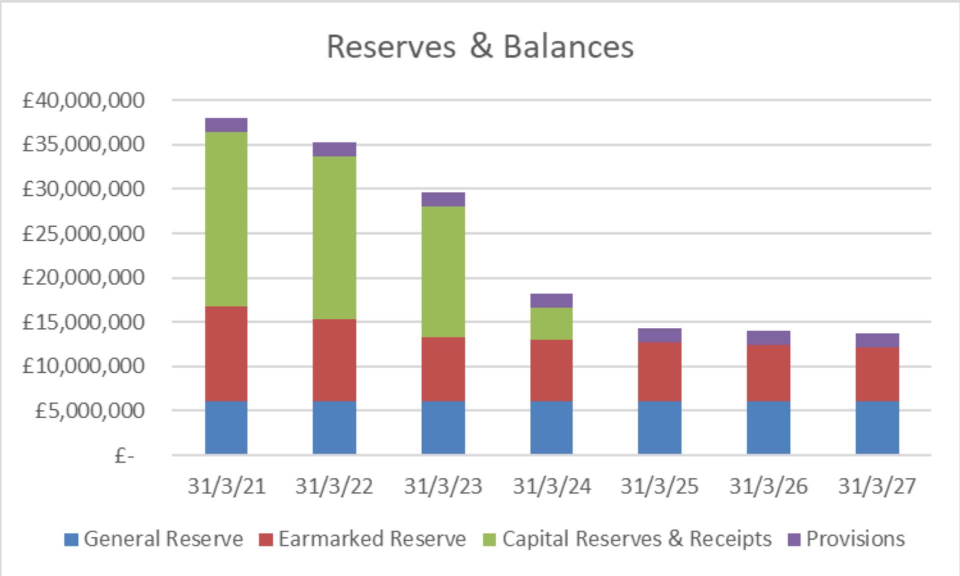
Summary Reserve Position

The following table sets out the summary anticipated position in terms of reserves and balances, a more detailed year on year analysis by reserve is attached as appendix 1:-

Table 8 Summary Use of Reserves March 21 to March 27

	General Reserve	Earmarked Reserve	Capital Reserves & Receipts	Total Usable Reserves	Provisions	Total Reserves & Balances
	£m	£m	£m	£m	£m	£m
Balance 31/3/21	6.0	10.8	19.6	36.5	1.6	38.0
Change in year	0.0	(1.5)	(1.3)	(2.7)	0.0	(2.7)
Balance 31/3/22	6.0	9.3	18.4	33.7	1.6	35.3
Change in year	0.0	(2.1)	(3.6)	(5.7)	0.0	(5.7)
Balance 31/3/23	6.0	7.3	14.8	28.1	1.6	29.6
Change in year	0.0	(0.4)	(11.1)	(11.4)	0.0	(11.4)
Balance 31/3/24	6.0	6.9	3.7	16.6	1.6	18.2
Change in year	0.0	(0.3)	(3.7)	(3.9)	0.0	(3.9)
Balance 31/3/25	6.0	6.6	0.0	12.7	1.6	14.2
Change in year	0.0	(0.2)	0.0	(0.2)	0.0	(0.2)
Balance 31/3/26	6.0	6.4	0.0	12.4	1.6	14.0
Change in year	0.0	(0.3)	0.0	(0.3)	0.0	(0.3)
Balance 31/3/27	6.0	6.1	0.0	12.2	1.6	13.7

Graph 1 Reserve Balances March 21 to March 27



The level of reserves reduces by over £20m over the next 3 financial years, reflecting the scale of the capital programme. Our general reserve remains above our minimum requirement throughout the period, reflecting the increase in council tax included in the revenue budget report. The position will be subject to significant change as pension costs, funding, inflation, pay awards etc become clearer in future years. The annual refresh of this policy will identify the impact of any changes as they develop.

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 can 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

Table 9 Details of any background papers

Paper:
Date:
Contact:
Reason for inclusion in Part 2 if appropriate:

Appendix 1

Reserve Balances by Year

Table 10 Detailed Use of Reserves March 21 to March 27

	31/03/22	31/03/23	31/03/24	31/03/25	31/03/26	31/03/27
	£m	£m	£m	£m	£m	£m
General	**6.0**	**6.0**	**6.0**	**6.0**	**6.0**	**6.0**
Earmarked						
Section 31 Business Rate Relief Grant	1.1	-	-	-	-	-
C/Fwd Timing Issues	0.3	0.1	-	-	-	-
Specific Grants	0.1	-	-	-	-	-
DFM	0.2	0.2	0.2	0.2	0.2	0.2
PFI	5.2	5.0	4.8	4.5	4.3	4.0
Insurance ASL	1.1	1.1	1.1	1.1	1.1	1.1
Princes Trust	0.5	0.5	0.5	0.5	0.5	0.5
Apprentices	0.1	0.1	0.0	-	-	-
Equipment	0.2	-	-	-	-	-
Innovation Fund	0.5	0.2	0.2	0.2	0.2	0.2
Minor Balance	0.1	0.0	0.0	0.0	0.0	0.0
	9.3	**7.3**	**6.9**	**6.6**	**6.4**	**6.1**
Capital Reserves & Receipts	**18.4**	**14.8**	**3.7**	**0.0**	**0.0**	**0.0**
Provisions						
Insurance	0.5	0.5	0.5	0.5	0.5	0.5
Business Rate Collection Fund Appeals	1.1	1.1	1.1	1.1	1.1	1.1
	1.6	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**
	35.3	**29.6**	**18.2**	**14.2**	**14.0**	**13.7**