LANCASHIRE COMBINED FIRE AUTHORITY
Meeting to be held on 20 February 2017

RESERVES AND BALANCES POLICY

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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) and earmarked reserves (those held for a specific purpose). 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.

Recommendation

The Authority is requested to approve the policy and the level of reserves included within it.

Reserves and Balances Policy

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, etc.

The Government has confirmed that the multi-year settlement offers have been agreed with all single purpose fire and rescue authorities. Hence barring exceptional circumstances, and subject to the normal statutory consultation process for the local government finance settlement, the Government expects these amounts to be presented to Parliament each year, up to 2019/20. This provides much greater certainty. It should still be noted that this period will see an end to the current funding model with a move to full retention of business rates and the phasing out of Revenue Support Grant, the actual details of which are still unknown and which may impact on the settlements outlined.

The Treasurer considers it prudent to reduce the minimum target reserves level to £2.8m, 5.0% of the 2017/18 net revenue budget, a reduction on previous years due to indicative four year settlements but still maintained at a reasonable level to reflect on-going economic uncertainty and the underlying risks within the budget.

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.

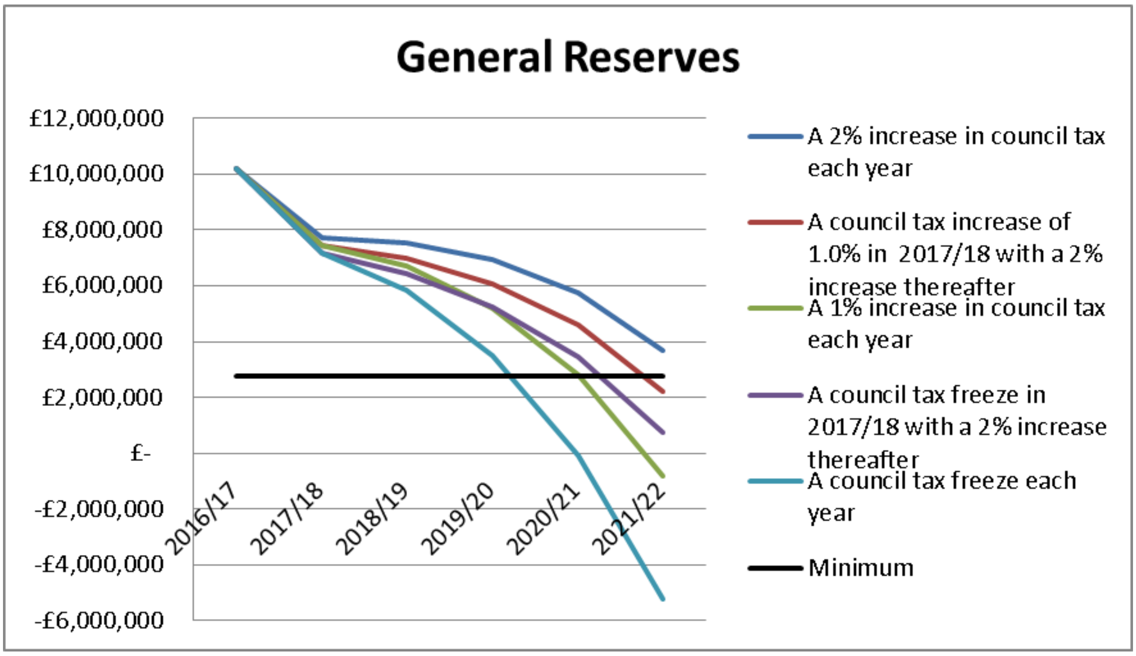
Should this be exceeded the following financial year's budget will contain options for applying the excess balance in the medium term, i.e. over 3-5 years.

<u>Current level of General Reserves</u>
The overall level of the general fund balance, i.e. uncommitted reserves, anticipated at the 31 March 2017 is £10.2m. The draft capital programme allows for a further transfer of £2.6m from general reserve to the capital programme in 2017/18, leaving a forecast balance of £7.6m, providing scope to utilise approx. £4.8m of reserves.

Based on current assumptions, and dependent upon council tax decisions, further drawdowns of between £0.7m and £4.1m may be required to balance the revenue budget over the next 3 years, i.e. the remainder of the multi-year settlement. This would reduce our overall general reserve level to between £6.9m and £3.5m, still within our target range.

Thereafter the position is less clear as multi-year settlements have ended and the budget forecasts become less accurate as there are a whole host of assumptions underpinning these projections, particularly around vacancy profiles, pension costs, future inflation and pay awards.

Assuming general reserves were used to balance the overall position each year this would deliver a sustainable position throughout the period based on a 2% increase in council tax each year, whereas reserves would run out in 2020/21 if council tax was frozen each year:-



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 Finance
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.

Current level of Earmarked Reserves

The following table provides a breakdown of the £9.5m of earmarked reserves held at 31st March 2016, as previously agreed by Resources Committee, and a forecast of the anticipated position as at 31 March 2022:-

	Balance at 31 March 2016	Forecast at 31 March 2022	
	£m	£m	
DFM Reserve	0.4	0.4	Devolved Financial Management Reserve enables budget holders to carry forward any surplus or deficit from one financial year to the next, within prescribed limits, giving greater flexibility and optimising the use of resources. This is utilised by the individual budget holder, as required. 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.
PFI Reserves	3.4	3.1	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 is assessed on an annual basis by the Treasurer.
New Dimensions Funding	0.4	0.1	To fund further training / expenditure in respect of the USAR team.
Retained Bounties	0.1	-	Following the introduction of the New Fire-fighters Pension Scheme in April 2006 all accrued liabilities in respect of retained bounties were frozen at that point in time, with the amounts being set aside in this earmarked reserve. As these bounties become payable the reserve is used to offset the revenue cost of this, with the final payment due in the current year.
Equipment	0.1	0.1	This reserve has been created to smooth the timing effects of replacing equipment, and meet large one off purchases that would otherwise directly impact the revenue budget and lead to large fluctuations in revenue budgets each year.
Insurance Aggregate Stop Loss (ASL)	1.4	1.4	The Authority's current insurance policies have a combined aggregate stop loss (ASL) of £0.7m (the self-insured loss liability for vehicles standing at £0.3m and the combined insurance liability standing at £0.4m). As such the reserve, combined with amounts within the revenue budget (£0.2m per annum), provides sufficient cover to meet 3 years' worth of the maximum possible loss.
Backlog Maintenance	0.2	-	This reserve was created to tackle backlog maintenance identified in both the last stock

			condition survey and works at STC. We anticipate utilising this by the end of next year.
ICT	0.2	-	The remaining balance will be used on future ICT projects in order to deliver improved ways of working and facilitate on-going efficiency savings.
Restructure	2.0	-	The reserve was set up to provide funding to meet any restructuring costs associated with the review of service provision. Given the improvement in funding, and the move to multi-year settlements this should not be required in future years, and hence the balance has been transferred into the capital funding reserve to meet future capital commitments.
Princes Trust Volunteers	0.2	0.2	This reserve covers financial pressures arising from potential loss of secondees from partners, and the short term nature of funding arrangements through the colleges we work with, giving short term security to the activities of the Prince's Trust, and cushioning the adverse effects of any funding cuts which occur in the future.
Youth Engagement Scheme/Community Fire Safety projects	0.1	-	This reserve reflects income collected from various sources to fund area based youth related projects, such as Fire Cadets.
PWLB	1.0	-	This reserve has been created to meet the potential penalty costs associated with repayment of the PWLB loans. 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. As reported in the Treasury Management Strategy, elsewhere on this agenda, the Authority has £5m of existing debt as a result of previous years' capital investment. As part of the Strategy adopted in 2014/15 additional MRP payments have been made which would enable loans to be repaid on maturity without the need to replace them or if advantageous to repay loans early. Any early repayment of loans will attract a penalty, and this currently stands at £1.5m The penalty varies throughout the period of the loan dependent upon how long the loan has to maturity and how the interest rate on the loan compares to current market rates. As such a sum has been set aside to meet the majority of any penalty arising should the Authority choose to repay these at a future date. For the purpose of forecasting we have assumed that this occurs in 2018/19.
	9.5	**5.3**	

It is worth noting that of the anticipated balance of £5.3m, £3.1m relates to the PFI reserve with a further £1.4m relating to the insurance reserve.

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 does not qualify. The Authority does not currently intend to do so. Whilst the Authority currently holds £1.5m of capital receipts all of which pre-dates the new regulation and hence cannot be used in this way. Furthermore the Authority only has one surplus capital asset, a small piece of land in South Ribble, on which it is currently reviewing disposal options, however it is not anticipated that this will generate significant capital receipts. Hence for the purpose of planning we have not assumed any capital receipts will be used to meet 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 are 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 2016 the Authority held £11.8m of capital reserves and receipts. We anticipate utilising £2.5m of this in 2016/17; however we also anticipate transferring a further £4.3m into this from the restructuring reserve referred to earlier and from the in-year underspend. As such we anticipate a year-end balance of £13.6m. Based on the capital programme presented elsewhere on this agenda we anticipate utilising a further £10.6m by 31 March 2022, leaving a balance of £3.0m to fund future capital programmes.

Provisions

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

Insurance Provision

This covers potential liabilities associated with outstanding insurance claims. The precise costs of these are uncertain but 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. Until such time as the year-end position is known it is not possible to estimate, with any accuracy, the likely changes to this provision. As such this is not available to meet other budget pressures.

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

At 31 March 2016 this provision stood at £1.2m to cover anticipated costs of outstanding insurance claims. Whilst an element of this will be utilised in the current financial year, reflecting the settlement of outstanding claims, it is impossible to accurately predict the extent of this usage or the need for any additional provision to meet claims 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 insurance provision remains unchanged.

Retained Fire-fighters’ Provision

This covers potential liabilities associated with Retained Fire-fighters’ claims (under the Part-Time Workers (prevention of less favourable treatment) Regulations 2000) concerning employment terms and eligibility to be part of the Fire-fighters’ Pension Scheme, which is subject to negotiation at a national level. As such this is not available to meet other budget pressures.

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

Name	Retained Fire-fighters’ Provision
Purpose	This covers monies set aside to meet future costs associated with the Retained Fire-fighters’ claim
Utilisation	Once set up the provision can only be utilised to meet costs associated with settlement of such 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 national guidance to ensure the level of the provision is appropriate and is still required

At 31 March 2016 this provision stood at £0.1m, which is in line with the latest estimated cost and we anticipate utilising all of this in the current financial year.

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.

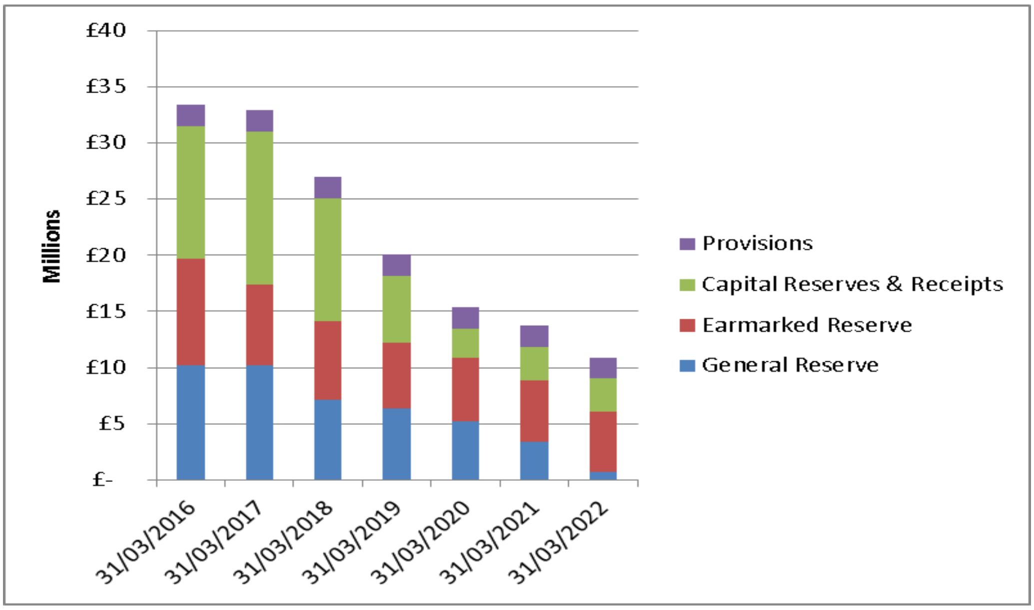
Name	**Business Rates Collection Fund Appeals Provision**
Purpose	This covers monies set aside to meet the Authority's share of the cost of successful business rates appeals
Utilisation	Once set up the provision can only be utilised to meet costs associated with settlement of such appeals
Controls	The 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 2016 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.

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. £11m by 31 March 2022 (for the purpose of forecasting we have allowed for a council tax freeze in 2017/18 and 2% increases thereafter and have assumed that all funding gaps are met from utilisation of general reserves):-

	General Reserve	Earmarked Reserve	Capital Reserves & Receipts	Provisions	Total Reserves & Balances
	£m	£m	£m	£m	£m
Balance 31/3/16	10.2	9.5	11.8	1.9	33.4
Change in year	0.0	(2.3)	1.8	(0.0)	(0.5)
Balance 31/3/17	10.2	7.2	13.6	1.9	32.9
Change in year	(3.0)	(0.2)	(2.7)	0.0	(5.9)
Balance 31/3/18	7.2	7.0	10.9	1.9	26.9
Change in year	(0.8)	(1.2)	(5.0)	0.0	(6.9)
Balance 31/3/19	6.4	5.8	5.9	1.9	20.0
Change in year	(1.2)	(0.2)	(3.3)	0.0	(4.7)
Balance 31/3/20	5.2	5.6	2.6	1.9	15.3
Change in year	(1.8)	(0.2)	0.3	0.0	(1.6)
Balance 31/3/21	3.4	5.5	2.9	1.9	13.7
Change in year	(2.7)	(0.2)	0.0	0.0	(2.8)
Balance 31/3/22	0.7	5.3	3.0	1.9	10.9



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 but as already highlighted 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.

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 2016 & February 2017	Keith Mattinson
Revenue, Capital Budget and Treasury Management Strategy Reports to CFA	December 2016 & February 2017	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		