

RESERVES STRATEGY 2019-24

Background

1. The requirement for a local authority to maintain financial reserves is acknowledged in legislation: the Local Government Act 1992 requires billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.
2. In addition to holding financial reserves, there are a number of safeguards in place that mitigate against the risk of local authorities over committing themselves financially:
 - There is a legal requirement to set a balanced budget;
 - In accordance with the 1988 Local Government Finance Act the chief finance officer (Section 151 Officer) must report if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that expenditure will exceed resources;
 - The external auditor's responsibility to review and report on financial standing.
3. While it is primarily the responsibility of Members and the Section 151 Officer to maintain a sound financial position, external auditors have a responsibility to review the arrangements in place to ensure that financial standing is soundly based. The work undertaken by external auditors will include a review of the level of reserves and the advice given to members by the chief finance officer.
4. The May 2018 Fire and Rescue National Framework includes the requirement that fire authorities "should establish a policy on reserves and provisions in consultation with their chief finance officer". It also requires that "fire authorities should publish their reserves strategy, including details of the current and future planned levels, the purpose for which each reserve is held and how each reserve supports the medium term financial plan".

Determining the level of reserves

5. In accordance with Financial Regulations, the Authority holds reserves which fall into two distinct categories:
 - General Reserves: these are necessary to fund any day to day cash flow requirements and also to provide a contingency in the event of any unexpected events or emergencies, and

- Earmarked Reserves: these have been created for specific purposes and involve funds being set aside to meet known or predicted future liabilities. Such reserves are intended to smooth the expenditure profile and avoid liabilities being met from Council Tax or the need to make offsetting savings in the year that expenditure is incurred.
6. There is not a standard recognised formula for determining the level of reserve that each local authority should maintain. It is up to each authority to consider the local circumstances and the potential issues/risks that may occur across the medium term. In determining an appropriate level of reserves for Cheshire Fire Authority the range of risks and issues that should be taken into account will include the following:
- The possibility of additional savings being required in the future and the potential difficulty in delivering such savings. Future funding levels are uncertain until the results of the Spending Review are announced, probably in late 2019. If annual spending reductions were to increase in magnitude this may lead to the identification of savings proposals that may not prove to be deliverable;
 - To provide cover for extraordinary or unforeseen events occurring: given that the purpose of the fire and rescue service is to respond to emergency situations, there is always the potential for additional, unexpected and unbudgeted expenditure to occur;
 - The level of self insurance that we provide to minimise our insurance premiums: potential insurance liabilities can vary significantly across financial years. The levels of liabilities are difficult to accurately forecast and it would not be appropriate to budget for peak levels of expenditure.
 - Any additional delivery costs, or time lags in the implementation of savings, associated with collaboration initiatives such as the Blue Light Collaboration programme.
 - The commitments falling on future years as a result of capital plans and proposals to improve/develop the asset base. Having reserves would mitigate the impact on the revenue budget of borrowing and/or revenue contributions to capital and would support projects/programmes that will generate revenue efficiencies.
 - The risk on inflation, especially pay. Inflation, as measured by the retail prices index, is currently running at about 2.7%. Brexit is likely to have an impact on inflation, especially in the short term, and there is the potential for this to create upward pressure on pay inflation.

General Reserve

7. In recent years there has been considerable debate about the level of general reserves that are being held by local authorities. Whilst there is no specified minimum general reserve level, a broad rule of thumb adopted by most chief finance officers in local government has been that an appropriate and prudent level is one that is equivalent to 5% of budget. This has been recommended in the past in Audit Commission reports and has been included in recent comments by Government ministers as being an accepted “reasonable level” of general reserve.
8. The Fire and Rescue National Framework requires that a Reserves Strategy should explain how the “level of general reserve has been set” and should include “justification for holding a general reserve larger than 5% of budget”. This therefore adds weight to the adoption of 5% of budget as an appropriate calculation of the required level of general reserve.
9. For Cheshire Fire Authority, the level of General Reserve at 31 March 2018 stood at £8.2m, following the closure of the accounts for 2017/18. This is well above 5% of the revenue budget. As part of the Reserves Strategy approved in February 2018 the level of the General Reserve will be maintained at around £2.2m which is approximately equivalent to 5% of budget. It is a key component of this Strategy that if further revenue underspends occur – or if earmarked reserves are able to be released - that these are taken to Earmarked Capital Reserves to support the capital programme.
10. It is proposed that this approach be maintained across the medium term, with the General Reserve being maintained at £2.2m. The table set out in the Annex summarises the position to 2024. This Strategy will be kept under review as capital spending is incurred and the level of reserves is adjusted to reflect the actual position at the end of each financial year.

Earmarked Reserves

11. The Fire Authority has a number of earmarked reserves. These have been set aside to support capital and revenue expenditure in future years. In recent months there has been a thorough review undertaken of the need for some of the earmarked reserves and the likelihood of commitments arising has been challenged. This review was led by the Chief Fire Officer and Chief Executive. Details of the forecast levels of earmarked reserve are set out in Annex A. The forecast levels reflect the planned usage of reserves to meet anticipated expenditure. The main earmarked reserves are explained below.

IRMP Reserve

12. The purpose of this reserve is to meet the needs placed upon the Authority in meeting delivery programmes falling out of each IRMP. The reserve will be used in 2019/20 to finance the costs of some of the project teams that are implementing major capital projects and providing funding for temporary training facilities. Its continued use in supporting capital expenditure will mean the reserve will be fully depleted by 31/3/2021, unless there are additions from other reserves or revenue underspends.

Capital Reserve

13. The Government has ceased the practice of providing Capital Grants to local authorities although occasionally there are national initiatives announced that involve consideration of bids from local authorities in furtherance of Government priorities. Expenditure on the new training centre is to be financed from borrowing. There are other capital schemes, including new fire stations and the refurbishment programme, that have been approved in recent months and the Authority now has a sizeable capital programme.
14. To avoid further borrowing and incurring additional revenue expenditure, the strategy is to use contributions from reserves. As part of this strategy other earmarked reserves have been reviewed and where appropriate, taken to the capital reserve to support capital expenditure and to ensure that the capital reserve is not depleted entirely.

Resource Centre Reserve

15. This earmarked reserve is set aside to meet future identified commitments within the respective Resource Managers' areas. The amounts are attributable to the following issues/risks:

Staff related: there are a number of potential staff related issues including pension costs and future recruitment costs. A significant cost is likely to arise as a result of the triennial review of the local government pension scheme: a sum has been set aside to meet potential costs of £0.33m in 2020/21;

Legal and insurance: a balance of £0.6m is being maintained to meet any future prosecution and enforcement costs associated with the work of the protection team and to fund any successful claims which are self-insured;

ICT and systems development: approximately £0.2m is set aside to support ICT development work including any major system upgrades/replacements that may be required;

Training: approximately £0.1m is being earmarked for talent management and corporate training expenditure;

Equipment and uniforms: the balance on this reserve is reducing each year as it is used to meet the costs of new uniforms and new equipment, particularly protective equipment. By 2024 the balance on this reserve is forecast to be £0.5m;

Collaborations and partnerships: approximately £0.2m has been set aside to support the statutory duty to collaborate. The Authority has a number of collaboration initiatives including the North West Fire Control and Blue Light Collaboration with Cheshire Police;

Property related: a balance of £0.3m is being maintained to support property maintenance expenditure and to meet the costs of property related projects;

Prevention: there is a balance of £0.2m to support any future safety central marketing costs.

Community Risk Reduction

16. Amounts have been set aside to support the cost of the Authority's Safe and Well Programme and other community safety activities. There is approximately £0.3m in this reserve and until further commitments are identified, this will be the balance to March 2024.

Unitary Performance Group (UPG)

17. Amounts have been set aside for facilitating partner engagement in community safety activities. This includes funding for the sprinkler campaign. It is forecast that by the end of 2018/19 there will be approximately £0.1m in this reserve and, until further commitments are identified, this will be the balance to March 2024.

Overall Position

18. One of the key elements of the Reserves Strategy will be to use the earmarked Capital and IRMP Reserves to support capital expenditure. The Capital Strategy for 2019 to 2024 indicates that expenditure of over £30m is planned to take place between April 2019 and March 2022 with approximately £20m of this being financed from reserves. The resulting balances on reserves are set out in Annex A below.

FORECAST LEVEL OF RESERVES TO MARCH 2024

	Forecast at 31/03/2019	Forecast at 31/03/2020	Forecast at 31/03/2021	Forecast at 31/03/2022	Forecast at 31/03/2023	Forecast at 31/03/2024
	£000	£000	£000	£000	£000	£000
General Reserve	2,210	2,210	2,210	2,210	2,210	2,210
Earmarked Reserves						
IRMP	8,042	7,248	3,822			
Capital	11,858	3,565	100			
Resource Centre	3,909	3,613	3,130	3,062	2,999	2,402
Community Risk	314	314	314	314	314	314
UPG	367	117	117	117	117	117
TOTAL RESERVES	26,700	17,067	9,693	5,703	5,640	5,043