

Assessment of the Authority's financial risk and the levels of general balance needed (2013/14)

1 Introduction

- 1.1 The Local Government Act 2003 requires that the Treasurer should assess the financial risks faced by the Authority and make recommendations to mitigate the risks appropriate levels of resources involved.
- 1.2 In considering financial risks, a distinction must be made between:
- A **provision**, which is made for known liabilities. For example, the Authority currently has a provision for uninsured losses.
 - A **reserve**, which is set up to protect against the possibility of future costs that not yet liable and/or capable of being quantified. Reserves can include, a 'general balance' – which not earmarked for a specific purpose; or an 'earmarked reserve' set up for specific purpose (e.g. a reserve to meet future capital payments).

2 Assessing the level of general balance required

- 2.1 This involves assessing the risk – both the impact and likelihood – of the Authority having to deal with significant unplanned increases in expenditure. To help determine the overall level of reserve needed, some adjustment is made for:
- the unlikely event that all identified risks will occur in the same year;
 - the potential to use savings and/or transfers from underspent budgets (the Authority has a good recent record in achieving these); and
 - the potential use of capital funding.

3 Pensions fluctuations

- 3.1 The financial framework for pensions was established on 1 April 2006. This transferred the main financial risk associated with pensions expenditure from fire and rescue authorities to the Government. But there are still some risks that authorities face. One is the cost of dealing with any ill-health retirements and, based on the Authority's past experience a sum of £50,000 is considered sufficient.
- 3.2 At some point there will be an increase in the employers' pension contribution rates for firefighters although at this point it is unclear when that could be. It is recommended that a sum equivalent to

approximately 1% is included in the calculation – this is £245,000 bringing the total provision for pension related issues to £295,000.

4 Inflation risk: pay

4.1 The Government has announced that public sector pay will be capped at 1% for 2013/14 and 2014/15. It also announced a two-year public sector pay freeze for 2012/13 and then subsequently awarded firefighters a 1% pay award and there is always the possibility that we might experience a pay v prices inflationary spiral following the freeze. This could have a significant impact on budgets in 2013/14 and 2014/15 (for which the draft budget assumes only a 1% increase to pay budgets in each year). It would be prudent to anticipate the potential for this risk and increase this element of reserves by 1.0% for 2013/14, i.e. an increase of £385,000.

5 Uninsured risks

5.1 Although the Authority has comprehensive insurance covers in place, there are always some associated risks. For example, the Authority incurred significant costs in 1997-2001 because it had to obtain retrospective cover when its primary insurer went into liquidation. There are also some uninsured risks: e.g. for employment practice claims and the potential that we might need to deal with any emerging health and safety issues. This is one of the harder areas to assess, but there is no reason to increase the current figure of £600,000.

6 Extremes of weather

6.1 Unusually hot dry summers, wet winters and storms can all lead to additional operational costs. These are primarily associated with increased activity by retained firefighters and vehicle running expenses including fuel. The current provision of £250,000 would seem appropriate and no change is proposed to this figure.

7 Other inflation

7.1 There is some risk attached to non-pay inflation. In particular, energy and fuel costs are volatile. However, given the current levels of inflation it would seem prudent to allow approximately 1% for non-pay costs which is £100,000.

8 Capital programme issues

8.1 The Authority has a significant capital programme in place. The details of the capital settlement methodology for fire and rescue authorities has not yet been announced from 2013/14. Supported borrowing is no longer available and instead, funding is through capital grant and prudential (unsupported) borrowing. This causes problems for planning and funding the capital programme - especially given uncertainty over timing and value of capital

receipts, recently demonstrated with the former Winchester Fire station site.

- 8.2 It is appropriate, therefore, to continue to take the capital programme into account when considering the level of general balance to hold. It is difficult to rationalise a formula-based approach to this, but a slightly reduced sum of £850,000 would appear reasonable given the current level of the capital payments reserve.

9 **Uncertainties beyond 2013/14**

- 9.1 The largest new uncertainty is possibly the calculation of the value of the locally retained business rates by the billing authority. Although once declared as final by an individual authority for the following year it is fixed, the actual variation from that figure will be adjusted in the following financial year. Previously we have made assumptions for such uncertainties of: £800,000 in 2007/08, £400,000 in 2008/09 and £200,000 in 2009/10 - with £250,000 now built into the base budget. This was increased to £800,000 last year. Given that the Government funding has been announced for the next two years this gives a certain level of short-term security however the change to retained business rates funding would justify the retention of this level of reserve for uncertainty.

10 **Conclusion: level of reserves**

- 10.1 Bringing all these factors together leads to a 'maximum exposure' of £3,280,000 as set out in Table 1. However, as mentioned above, other funding sources may be available, and it is not likely that all these potential risks will occur in the same year. Experience bears this out. The Authority's outturn position has very rarely resulted in an overspend. In recent years underspends have been achieved. There are two other mitigating factors:
- The extent to which earmarked reserves could be diverted, at least on a temporary basis, to deal with changes in funding priorities or levels of perceived risk during the year.
 - The inclusion of a £250,000 contingency in the base budget. In addition the draft budget includes an increase of £100,000 to the corporate contingency budget to allow for the reduced flexibility to meet unexpected costs resulting from the reduction of other budget heads.
- 10.2 In theory it would be reasonable to discount the level of reserves required by up to 50% on the basis of these mitigating factors and the improbability of simultaneous reoccurrence. However, given the level of uncertainty on future funding, it is considered sensible to take a more cautious position. So, a reduction of only 25% is proposed. This would suggest general reserve of £2.5m would be appropriate. This will be kept under review.

- 10.3 This puts reserves at approximately 3.7% of the Authority's annual spend. While this may be an interesting comparative indicator, it should not be regarded a determinant of good practice when setting reserves. It does not take account of how much risk is being carried in the base revenue budget. The Authority's budget is built on a realistic basis with a prudent provision for future inflation.

Table 1: Summary of Factors

Factor	Assessed impact 2012/13 £000	Assessed impact 2013/14 £000
Pensions: payments	200	295
Inflation: pay	400	385
Uninsured risks	600	600
Extremes of weather	250	250
Inflation: other	100	100
Capital factors	1,100	850
Future years' uncertainties	800	800
	3,350	3,280
x 75%	2,513	2,460
Rounded £100,000	2,500	2,500

- 10.4 It is therefore proposed the budget for 2013/14 should be built on the basis of providing for a £2.5m level of general balance.