

Level of specific reserves and general balance 2010/11

1 Introduction

- 1.1 The Local Government Act 2003 requires that the Treasurer assess the financial risks faced by the Authority and makes recommendations based on this as to the appropriate levels of resources required to be held against these risks.
- 1.2 In considering financial risks, a distinction must be made between:
 - A **provision**, which is made for a known and quantified outstanding liabilities. For example, the Authority currently holds a provision for the likely costs of equal pay issues.
 - On the other hand, **reserves** are set up against the possibilities of future costs that are either not yet liable or capable of being quantified, or are kept in order to build up funds for specific reasons (earmarked reserves).

2 Level of general reserve required

- 2.1 The approach taken in this paper is to assess the risks of increased expenditure that the Authority faces during any given year. That then flows into an assessment of the level of un earmarked reserves required. Some adjustment is then appropriate given that:
 - there is a much smaller chance that all identified risks will occur in the same year; and,
 - the use of reserves is not the only means of meeting such pressures. Savings/transfers from underspent budgets are preferable (and the Authority has a good recent record in achieving these), together with other assistance available through the flexible use of capital funding.
- 2.2 The main factors used to evaluate the primary financial risks facing the Authority, together with the suggested amounts required to cover them, are summarised in the following sections.

3 Pensions fluctuations

- 3.1 The new financial framework for pensions, which came into force on 1 April 2006, transferred most of the risks in association with pensions expenditure from Fire Authorities to the Government (as clarified following the recent case regarding transfer for pensioners who retired prior to the alterations and scheme regulations). There are still some risks associated with pensions relating in the main to the number of ill-health retirements but given that they are paid over a three year period a sum of

£50,000 is considered sufficient.

- 3.2 In addition, however, it has recently emerged that retained firefighters will be able to buy up to six years backdated additional pensionable service, (with the cost of matching employer contributions which it has been assumed might spread over three years). It is hard to assess the likely degree of take-up should that occur, but on the basis that 50% of serving retained firefighters currently in the pension scheme opt into such arrangement, that would cost £900,000 in total. Given that this would be a factor in the new contingency discussed in 11.1 below, a sum of £200,000 would seem appropriate here. The total cover for pensions issues is therefore £250,000.

4 Inflation risk: Pay

- 4.1 There may be a need during the year to meet the costs of a pay award not known at the time of setting the budget, and £100,000 was allowed for this factor in 2009/10. The Government's announcement restricting increases to 1% for 2011-13, the level built into the 2011/12 forward budget, may be taken to set the context such that cover through reserves can sensibly be set at 0.25% for 2010/11, i.e. remaining at £100,000.

5 Uninsured risks

- 5.1 Although the Authority has insurance in place, there remain risks. There was a period when the Authority effectively became uninsured from April 1997 to June 2001 due to its primary insurer going into liquidation. There are also some uninsured risks, e.g. for employment practice issues; and, if there are higher than budgeted levels of insurance claims, then there will be higher excess costs to pay. This is one of the harder areas to assess, but there was no reason to alter the figure of £600,000, based on the historic number of uninsured risks tending to come forward and the continuing trend towards more litigation.

6 Extremes of weather

- 6.1 Unusually hot dry summers, wet winters and storms can all lead to additional operational costs, 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 levels: for example, energy and fuel costs. To allow for a possible 5% increase in these heads over and above the budgeted level of inflation would require £40,000.

8 Regionalisation

- 8.1 No recognition of regionalisation is thought necessary in calculating the level of general balance for 2010/11. This will, however, be an area to keep under review.

9 **Capital Programme issues**

- 9.1 The Authority has a significant capital programme under way. The timing of payments and capital and to a certain extent overall project costs are difficult to estimate. It would make sense in taking 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 sum of £600,000 would not appear unreasonable: that slightly reduces the 2010/11 figure, which reflected a higher level of imminent major spend and particularly severe initial uncertainty around capital receipts values in the recession.

10 **Uncertainties in 2010/11 and beyond**

- 10.1 The Authority continues to face some uncertainties, such as the transition to regional control arrangements and the introduction of Firelink. But other recent change agendas are now either integrated into normal working (e.g. IRMP, take up of pension by retained firefighters) or are provided for specifically (equal pay). Again it is difficult to rationalise a formula-based approach to these, but compared with £800,000 in 2007/08 and £400,000 in 2008/09 a sum of £200,000 would not appear unreasonable for the 2009/10 calculation, especially given the £250,000 built into the future base budget for such factors (see below).
- 10.2 However, the other key factor which has changed since 2009/10's assessment is the escalating impact of the recession on public finances, in particular the bleak prospects for future government support. It would seem reasonable to capture that by building into reserves the possibility of having to cope with a particularly bad settlement. With formula grant running at some £30m it would be reasonable to build into reserves the possibility of a reduction of 3% more than might otherwise be expected. That equates to £600,000.
- 10.3 That would bring the total figure for uncertainty to £800,000.

11 **Conclusion: level of reserves**

- 11.1 Bringing all these factors together leads to a 'maximum exposure' of £2,640,000 as set out in Table 1. However, as mentioned above, other funding sources may be available, and it is not likely that all these problems will occur in the same year. That is illustrated historically by the fact that the Authority's outturn position has very rarely resulted in an overspend, and recent years have produced underspends. There are also two other mitigating factors:

- The extent of earmarked reserves which could in case of particular

necessity be diverted to other uses, at least on a temporary basis. These are expected to rise to approximately £1.6m

- The inclusion of a recurring £250,000 in the base budget from 2011/12 onwards to cover the risks of possible but as yet hard-to-assess pressure on the revenue budget: while not directly relevant to 2010/11, that does reduce the future cover needed from reserves for the initial cost of such new pressures, should reserves be reduced during 2010/11.

In theory it might be reasonable to discount the level of reserves required by up to 50% for the mitigating factors above and the improbability of simultaneous recurrence of problems. However, it is considered sensible to take a more cautious position so a reduction of only 25% is proposed. This would suggest that an appropriate level of reserve is £2.0m. Naturally, the level will be kept under review.

11.2 This results in reserves at just over 3% of annual spend.

11.3 This is a relevant background factor, though not a determinant of good practice as it may be for example that less strict control of budgets is in place in such authorities, and Hampshire should also gain through the 'economy of scale' in spreading risks across a larger spending base than most. In addition this does not take account of how much risk is being carried in the revenue budget. Hampshire's budget is built on a realistic basis with prudent provision for future inflation being provided for.

Table 1: Summary of Factors

Factor	Assessed impact 2009/10 £000	Assessed impact 2010/11 £000
Pensions: payments	50	250
Inflation: pay	100	100
Uninsured risks	600	600
Extremes of weather	250	250
Inflation: other	80	40
Capital factors	800	600
Future years' uncertainties	200	800
	2,080	2,640
x 75%	1,560	1,980
Rounded £100,000	1,600	2,000

11.4 Accordingly, it is proposed the budget for 2010/11 should be built on the basis of providing for a £2.0m level of reserves.