



## **AGENDA ITEM: 15**

### **NORTH WALES FIRE AND RESCUE AUTHORITY**

**16<sup>th</sup> March 2009**

#### **COMBINED FIRE AND RESCUE AUTHORITIES' RESERVES**

**Report by Colin Everett, Clerk to the Authority**

#### **Purpose of Report**

- 1 To inform Members of recent discussions regarding the Combined Fire and Rescue Authorities' Reserves at the Welsh Local Government Association (WLGA) Council meeting held on 20<sup>th</sup> February 2009.

#### **Background**

- 2 Members will recall that this issue was highlighted by the Wales Audit Office (WAO) in June 2008. The WAO decided that Fire and Rescue Authorities in Wales did not have the necessary statutory powers to hold reserves, despite the fact that reserves have been held by authorities without accounting qualification since their establishment in 1996. A copy of the full report submitted to the WLGA Council meeting is attached.
- 3 The Clerk will give a verbal update at the meeting.

#### **Recommendation**

- 4 That Members note the information.

## **Combined Fire and Rescue Authorities' Reserves**

### **Purpose**

1. In June 2008 the Wales Audit Office (WAO) decided that Fire and Rescue Authorities (FRAs) in Wales did not have the necessary statutory powers to hold reserves, despite the fact that reserves have been held by authorities without account qualification since their establishment in 1996. This paper explains the issue and seeks Council's views on a proposed solution.

### **Background**

2. Three FRAs<sup>1</sup> were established in Wales in 1996 under a Combination Order, signed by the then Secretary of State. The order provides that fire service provision in Wales shall be discharged by a Fire Authority and Service as a completely separate legal entity from local authorities in Wales, based upon completely different geographical boundaries. The Combination Order also provides that the property, rights and liabilities held or incurred by authorities prior to 1996 were to be transferred to the FRAs upon their creation. As such, FRAs are discrete legal entities with powers to hold property and assets in their own name and not that of their constituent authorities. They are funded through direct contributions from constituent authorities at a level determined by the FRAs.
3. FRAs comprise members and councillors nominated by constituent local authorities in direct proportion to the registered local government electors in an area. The constituent authorities leave FRAs to discharge their functions and duties, recognising that liability for failure to discharge them rests with the Chief Fire Officers/Directors and FRA members.
4. In 1997-98 some FRAs had to seek supplementary contributions from their constituent authorities because they had not made adequate provision to discharge their functions. This caused difficulties for constituent authorities and they advised FRAs that they did not wish for a supplementary contribution to be sought in future years. As a result since that time, and in line with good and prudent financial planning, FRAs have sought to establish reserves and provisions to meet planned and unforeseen future expenditure. The use of reserves and provisions has helped FRAs to deal the shortfalls in fire fighter pension schemes and to plan properly and work flexibly between years. They have also protected constituent authorities from the need to provide supplementary contributions to FRAs during the financial year.
5. The levels of reserves and provisions have been established in full consultation with constituent authorities' treasurers and have varied according to the needs of each fire service. The terminology for the holding of the reserves has also varied,

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<sup>1</sup> South Wales fire and Rescue Authority (SWFRA); North Wales Fire and Rescue Authority (NWFRA); Mid and West Wales Fire and Rescue Authority (MWWFRA).

sometimes being referred to as reserves and sometimes as provisions, at the request of different WAO auditors over the years.

## **2007-08 Accounts**

6. The amounts that FRAs have set aside for reserves and provisions have been fully disclosed each year in their Statements of Accounts, which have received unqualified audit opinions from the WAO since 1996. However, in 2007-08 for the first time the FRAs all appointed the WAO as their external auditors and weeks before the accounts were due to be signed the WAO challenged the legality of holding reserves. The WAO confirmed that it would qualify the accounts of any FRA which held reserves at year end, but agreed not to take action against them if they accepted the qualified opinion. The WAO further advised the FRAs to approach the Welsh Assembly Government (WAG) to resolve the issue, but agreed not to use its legal powers to draw the matter to WAG's attention.
7. Due to the shortness of time, a compromise was found for the 2007-08 accounts which saw MWWFRA and NWFRA agreeing different accounting treatments with the WAO, thereby avoiding qualification. SWFRA however did not amend its accounts which were therefore qualified by the WAO. Given the current circumstances, SWFRA accepted a qualified audit opinion to protect its financial position, pending full resolution of this matter.

## **The Power to Hold Reserves**

8. We understand from the FRAs that the WAO, auditors (KPMG) and the constituent authorities that have been consulted are supportive of the principle that FRAs should have the power to retain reserves. The WAO agrees that the maintenance of reserves is prudent and sensible, that it is a power given to even the smallest of Community Councils and that it is considered to be sound financial management and good practice. CIPFA accounting guidance reinforces this view stating that organisations should maintain provisions and reserves as a matter of prudence. In practical terms FRAs use reserves and provisions are to:
  - Provide flexibility between years to enable the funding of work/contracts spanning more than one year to be managed effectively;
  - Avoid the need for supplementary contributions or handing back unspent resources to constituent authorities each year;
  - Pool resources for the purchase of land or equipment;
  - Fund the development and investment in new systems which take more than one year to introduce;
  - Enable invest to save and efficiency initiatives;
  - Provide for specific contracts where the timing is uncertain;
  - Fund the costs associated with responding to flooding/severe weather conditions and unusual operational incidents;
  - Set up a fund to pay for the additional costs of early retirements under the efficiencies policy;
  - Create a general contingency fund; and
  - Set aside resources for specific reasons, such as pensions.

9. The question the WAO has raised is not whether the authorities should be able to hold reserves, but whether they are legally able to do so. The WAO's position is based on legal advice it has obtained, but the FRAs consider that the position may not be as clear cut as that legal advice suggests. The FRAs are drawing on advice received from the Home Office in 1999 which clearly indicated that they are legally able to hold reserves and to retain any year end under spends. To avoid potentially protracted legal dispute over this point FRAs have approached WAG to ask for the Combination Order to be amended to clarify the position.
10. The WLGA has held initial discussions with the relevant WAG officials to determine whether this is possible and practicable and have been advised that WAG would be content to make what would be a relatively straight forward amendment. We think there is a strong case for fire authorities to have the power to retain reserves and seek Council's support

## Reserve Levels and Utilisation

11. Consideration of whether FRAs should have the power to hold reserves leads to the question of whether they should be free to set the level of such reserves or whether a limit be imposed. Views from auditors suggest that it is prudent for organisations to set aside general contingency reserves of between 3% and 5%, in addition to other specific reserves in addition. The table below shows the level of reserves held by the three FRAs in Wales, compared to their gross annual expenditure since 2006-07.

### Fire authority gross revenue expenditure and reserves

Authority	2006-07		2007-08		<i>as % of gross expenditure</i> 2008-09	
	Earmarked financial reserves at beginning of financial year	Unallocated financial reserves at beginning of financial year	Earmarked financial reserves at beginning of financial year	Unallocated financial reserves at beginning of financial year	Earmarked financial reserves at beginning of financial year (a)	Unallocated financial reserves at beginning of financial year (a)
Mid and West Wales Fire Authority	9.26%	0.00%	9.51%	0.00%	8.41%	0.00%
North Wales Fire Authority	10.48%	0.00%	0.00%	0.00%	0.02%	0.00%
South Wales Fire Authority	3.22%	4.22%	5.14%	8.47%	8.64%	8.02%
Total Fire Authorities	6.59%	2.05%	5.35%	4.12%	6.72%	3.94%

Source: 2006-07, 2007-08 and 2008-09 (reserves) figures are from Revenue Outturn Forms. 2008-09 gross revenue expenditure figure from Revenue Account budgeted forms

(a) Figures derived from 2007-08 reserves figures combined with in-year appropriations to/from reserves.

12. The FRAs' current forward financial plans rely upon the use of reserves:
  - SWFRA has recently purchased a new headquarters (HQ) site and is due to relocate early in 2009, while the sale of the existing HQ site has fallen through and is unlikely to proceed for some time due to economic conditions. Funds have also been accumulated for other various expenses in addition to a general reserve for unforeseen expenditure;

- Due to the new HQ purchase the SWFRA 2008-09 budget includes £2.88 million from reserves, with a further £1 million committed in 2009-10;
- MWWFA reserves are absolutely critical in supporting the budget over the next five years as a result of the pensions underfunding experienced in 2007-8. A plan that reduces the FRA budget's reliance on reserves has been agreed with the constituent authorities benefiting from the mitigating effect of these reserves. The budget is being supported by reserves to the tune of £1.4 million in 2008-09, £680,000 in 2009-10 and £580,000 in 2010-11. This will leave a balance of around £2 million;
- Although these reserves have been removed from the accounts of the MWFRA all the constituent authorities are showing the reserves separately in their own accounts for the specific use of the FRA. This demonstrates the support being given by the constituent authorities and the benefit they see in FRAs having access to reserves.
- NWFRA has made provisions towards
  - (i) meeting the final costs of relocating its Control Room to a joint facility operating in conjunction with NW Police. The relocation was to have occurred by 31 March 2008 but overran by a short period of time meaning some costs would be incurred in 2008/09 (£143k)
  - (ii) the potential cost of Equal Pay claims related to Retained Duty Staff (£200k)
  - (iii) the potential cost of lump sum contributions to the Pension Account of ill health retirements (£265k)

These amounts are not material in relation to the overall budget of NWFRA but do support the proposal for agreeing to proper accounting practices in accordance with relevant recommended practice and reporting standards applicable to public sector statements of accounts.

13. FRAs have an overarching duty to deliver their statutory responsibilities and their treasurers have a legal duty to provide proper financial advice enabling those responsibilities to be discharged. Reserve utilisation plays a significant part in current and medium term plans and the level of the reserves required should arguably be driven by need rather than a predetermined limit which could become either an imprudent restriction on FRAs or a target which ties up unnecessary funding from constituent authorities.
14. The table above shows that reserves have varied from between two per cent and four per cent over the years and these levels have been agreed using the corporate governance arrangements that are currently in place. As far as we are aware since their establishment there have been no conflicts between FRAs and constituent authorities regarding the level of FRA reserves and we therefore suggest there is nothing to be gained from introducing a reserve limit at this point. It may be that members wish to review this position in the future to see if that situation has

altered, but in the meantime we recommend that Members agree to leave the current arrangements as they are.

## Recommendations

**15. Members are invited to consider the paper and to agree that the WLGA should:**

- 15.1 agree with the principle that FRAs should be able to hold reserves;**
- 15.2 support the FRAs in the case they are making to WAG to have the Combination Order amended accordingly; and**
- 15.3 endorse the current corporate governance arrangements through which FRA reserve levels are determined.**

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