BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 6**

Resources Committee **5 February 2014**

Report of Head of Finance

Policy on Reserves and Balances

1 Purpose of report

This report outlines the current position on both Revenue Reserves and Capital Reserves, and reviews the Reserves Policy used for the governance of these balances.

2 Executive summary

2.1 The Council as at 1st April 2013 held approx. £4m of General Fund Revenue Reserves, £3.5m of Ear Marked revenue reserves, a total of approx £7.5m total revenue reserves and £13m of Capital Reserves. These balances will be utilised in the year and are currently estimated to be at approx. £5.5m of Revenue Reserves and £8m Capital Reserves. In 2014-15 the revenue budget is reliant on the use of approx. £1.6m of reserves to maintain a balanced position. In future years, if no further savings or efficiencies are identified this reliance rises to approx. £2.4m per annum and at that rate of expenditure the reserves will fall below the minimum level in 2015-16.

2.2 Capital reserves are estimated to be £8m at the end of 2013-14. The current minimum level of reserves is set at £5m. This allows for approx. £3m of capital expenditure from reserves with the addition of approx. £1.2m capital receipts each year, a total of approx. £4.7m over the period up to 2017-18. This is approx. £1.5m of additional capital expenditure per year over the medium term.

2.3 The use of reserves should be governed by a policy agreed by members and the reliance on reserves to balance the revenue budget in future years should be reduced so that the revenue budget is fully funded from other forms of income.

3 Appendices

Appendix 1: Current forecast use of revenue reserves
Appendix 2: Revised Policy on the Use of Reserves and Balances

4 Proposed action: The committee is invited to RESOLVE to:

4.1 **Agree the Revised Reserves Policy at Appendix 2**

5 Background

5.1 This report proposes a revision and refresh of the policy on the use of reserves. The use and level of reserves will be an essential part of the Councils financial strategy for the coming year. In response to this the budget process for future years should focus on delivering a plan which reduces the reliance on reserves and ensures the Council's finances are sustainable.

5.2 Although the level of general fund reserves is currently sufficient to support the revenue budget for the next year they are not renewable forms of finance and at some point in 2015-16 will fall below the current minimum level. The Council needs to use the reserves prudently to ensure that they enable the delivery of a balanced budget in future years, whilst remaining at a level to allow for any risks to be mitigated.

5.3 Capital Receipt reserves are also currently being used faster than they are being replenished. The Capital programme proposed for 2014-15 reflects the reduction in available resources at the current time but also recognises that as resources become available in the future the programme may be expended.

5.4 It is for this reason that a policy that governs the use of reserves is needed to ensure that these balances are used wisely to crate the maximum flexibility and value for the Council.

6 Discussion

6.1 Setting the level of general reserves is one of several related decisions in the formulation of the Medium Term Financial Strategy (MTFS) and the annual budget. This decision requires account to be taken of the strategic, operational and financial risks facing the authority. Specifically, the MTFS requires the Council to build and then maintain general reserves sufficient to cover the key financial risks that it faces. The Chief Finance Officer will need to consider many factors in determining the precise level of reserves, many of which involve an assessment of the risk of assumptions included in the budget and MTFS, together with the Council’s financial standing and management.

6.2 The Council recognises the need to hold and maintain reserves but also recognises that by choosing to hold or increase reserves, the Council is allocating resources away from other potential uses and as such, there is an “opportunity cost” of holding balances as reserves. For this reason it is important to set out clearly, and regularly review, the framework through which such reserves are managed.

6.3 Sections 32 and 43 of the Local Government Finance Act 1992 require local authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

6.4 There is no specified minimum level of reserves that an authority should hold and Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (Section 151 Officer) to report formally on the adequacy of proposed reserves when setting a budget requirement and to ensure that there are key protocols for their establishment and use. The Chief Finance officer has written a

Section 25 report for the 2014-15 budget which details the consideration for the minimum level of reserves she feels is prudent and sufficient.

6.5 It is prudent financial management to review all reserves periodically in order to ensure that the reserves are adequate, relevant and set at the right level to guard against known future liabilities.

6.6 As recommended in official guidance the review of reserves is closely aligned to the formulation of the budget for the forthcoming year and the Medium Term Financial Strategy, which contains estimates of the use of earmarked reserves and general fund balances

6.7 The relevance and adequacy of reserves will be reviewed on an ongoing basis and formally reviewed on an annual basis.

6.8 The policy on the use of reserves and balances is shown at Appendix 2. The committee is asked to agree this Reserves Policy.

Changes to Reserves for 2014-15

6.9 In 2013-14 the Reserves policy was formally adopted and the creation of new reserves agreed. As part of the on-going review of reserves for 2014-15 further new reserves are being proposed for both Revenue and capital funds.

6.10 The 2013-14 budget included an item for the pressure on budgets from welfare reform changes. The balance of this budget not currently used in 2013-14 should be ear marked for future liabilities. Once the final revenue outturn is known the balance outstanding will be transferred to a new Welfare reform pressure reserve.

6.11 The capital receipts reserves will be fully utilised once the capital programme for 2014-15 has been agreed. It is envisaged that during the year strategic asset sales will take place that add to the reserve. However, if the council continues to sell assets without using some of the proceeds of sales to replace assets with future sales potential or revenue income streams, the Council will find itself in a position where its choice to fund its capital spending is to cut revenue budgets or take on borrowing. Neither of these options are currently part of the council financial strategy. It is therefore proposed to ear mark some of the predicted capital receipts from strategic asset sales for future investment assets. This has been included as part of the refreshed and reviewed Reserves Policy at Appendix 2.

7 Legal powers

- Sections 32 and 43 of the Local Government Finance Act 1992
- Section 25 of the Local Government Act 2003

8 Financial and value for money implications

8.1 This report details the policy for the use of reserves and balances for the future and has no direct financial or value for money implications of its own.

9 Risk analysis

This table needs to be completed for any report setting out a proposed course of action that entails risks at the outset of the project or if the risks change along the way.

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
If no governance arrangements are in place reserves may be eroded without providing value to the Council.	The level of Minimum level of reserves will be breached	Unlikely if policy adhered to	Use of reserves is closely monitored New proposals to reduce spending or increase income are developed in a timely manner

10 Implications for resources

There are no implications for staffing or property resources.

11 Implications for stronger and safer communities

There are no implications for health improvement, community cohesion, and community safety matters under the local area agreement.

12 Implications for equalities

There are no implications for the council's duty to design its services around the needs of local people, and to evaluate the impact of its services, policies and activities on different groups in society to eliminate discrimination.

13 Author and contact officer

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14 Consultees

Senior Management Team
Julie O'Connell Service Accountant

15 Background papers

February 2013 Resources Committee report on reserves policy.
CIPFA LAAP Bulletin 77

Transfers to/from Earmarked Reserves Note 8

	Reserves	Balance 31st March 2012 £'000	Transfers in 2012/13 £'000	Transfers out 2012/13 £'000	Balance 31st March 2013 £'000	Transfers in 2013/14 £'000	Transfers out 2013/14 £'000	Balance 31st March 2014 £'000
W513	**Efficiency and Restructuring Reserve**	-758	-	231	**-527**		184	**-343**
W577	**Budget Implementation Reserve**	-	-2,000	-	**-2,000**		1,890	**-110**
W512	**Corporate Budget Reserve**	-	-170	-	**-170**			**-170**
W536	**Property Service Charges**	-	-312	63	**-249**			**-249**
W537	**Community Rights**	-	-14	-	**-14**			**-14**
W520	**Housing and Planning Delivery Grant**	-132	-	132	**0**			**-**
W519	**S.38 Highways Adoption Grant**	-31	-	31	**0**			**-**
W517	**Election Postage**	-18	-	18	**0**			**-**
W521	**VAT Reserve**	-121	-	-	**-121**			**-121**
W527	**Planning Reserve**	-133	-82	-	**-215**			**-215**
VARIOUS	**Miscellaneous Revenue Grants Reserve**	-236	-2	37	**-201**		13	**-188**
W529	**Neighbourhood Dev Reserve**	0	-19	-	**-19**			**-19**
W526	**New Burdens Impact Reserve**	-51	-	51	**0**			**-**
	Earmarked Reserves	**-1,480**	**-2,599**	**563**	**-3,516**	**0**	**2,087**	**-1,429**
	General Fund	-7,028	-761	3,680	**-4,109**	0	0	**-4,109**
		-8,508	**-3,360**	**4,243**	**-7,625**	**0**	**2,087**	**-5,538**

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Appendix 2

FINANCIAL RESERVES AND BALANCES POLICY

1. Purpose

The borough Council of Wellingborough is required to maintain adequate financial reserves to meet the needs of the organisation. The purpose of this policy is to set out the governance arrangements for the Use of Reserves and Balances to ensure they provide the Council with the flexibility it needs and also to ensure they are used to add value to the organisation.

2. Regulatory Context

Sections 32 and 43 of the Local Government Finance Act 1992 require local authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

There is no specified minimum level of reserves that an authority should hold and Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (Section 151 Officer) to report formally on the adequacy of proposed reserves when setting a budget requirement and to ensure that there are key protocols for their establishment and use.

This Policy sets out the framework for the use and management of useable reserves, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice (CIPFA/LASAAC) and agreed accounting policies

3. Types of Reserves

Useable reserves can be categorised in two ways:

- General Reserves which are a contingency to cushion the impact of unexpected events or emergencies and
- Earmarked Reserves which are generally built up to meet known or predicted liabilities.

Earmarked reserves are usually created and held for one of the five main reasons below:

1. Renewals – to enable services to plan and finance an effective programme of vehicle and equipment replacement and planned property maintenance. These reserves are a mechanism to smooth expenditure so that a sensible replacement programme can be achieved without the need to vary budgets.

2. Carry forward of underspend - some services commit expenditure to projects, but cannot spend the budget in year. Reserves are used as a mechanism to carry forward these resources.

3. Trading accounts – In some instances surpluses are retained for future investment.

4. Insurance reserve – to meet the estimate of future claims to enable the Council to meet the excesses not covered by insurance.

5. Other earmarked reserves will be set up from time to time to meet known or predicted liabilities, for example future predicted budget demand pressures.

Whilst earmarked reserves are set against a specific purpose, general reserves are funds which do not have any restrictions as to their use. Such reserves can be used to smooth the impact of significant pressures across years, offset the budget requirement in year, and to mitigate the risks of unexpected events or emergencies.

General Reserves can also be used to support investments designed to secure greater base budget savings.

4. Managing reserves

The Council recognises the need to hold and maintain reserves but also recognises that by choosing to hold or increase reserves, the Council is allocating resources away from other potential uses and as such, there is an "opportunity cost" of holding balances as reserves. For this reason it is important to set out clearly, and regularly review, the framework through which such reserves are managed.

The management of financial reserves is a key tool of the Council�s overall financial strategy, which has two key objectives:

- achieving stable and sustainable budgets throughout the medium term; and
- ensuring resources are effectively focussed on priorities.

Underpinning the achievement of these objectives is the recognition of the need to manage risk. This could be the increased risks of volatility in planning assumptions as we continue to go through uncertain economic times, or the risks to Government funding as a result of significant future funding reviews. Or it could be that the business seeks to take greater business risks through innovative service delivery to achieve difficult savings targets. The greater the risks, the greater the reserves the Council are likely to need to hold to mitigate against this. It is the appreciation of such risks that must be at the forefront of the Chief Finance Officer�s Section 25 report, referred to in Section 2 above.

5. Quantifying the Reserves Requirement

Setting the level of general reserves is one of several related decisions in the

formulation of the Medium Term Financial Plan (MTFP) and the annual budget. This decision requires account to be taken of the strategic, operational and financial risks facing the Authority. Specifically, the MTFP requires the Council to build and then maintain general reserves sufficient to cover the key financial risks that it faces.
The Chief Finance Officer will need to consider many factors in determining the precise level of reserves, many of which involve an assessment of the risk of assumptions included in the budget and MTFP, together with the Council's financial standing and management.

The key factors are set out below.

- Budget assumptions
- Financial standing and management
- General cash flow requirements
- The outlook for inflation and interest rates.
- The overall financial standing of the Council (level of borrowing, debt outstanding, etc)
- Estimates of the level and timing of capital receipts.
- The Council's track record in budget and financial management including the robustness of its medium term plans.
- The potential range of costs of demand led services.
- The Council's capacity to manage in year budget pressures.
- Planned efficiency savings/productivity gains.
- The strength of the financial information and reporting arrangements.
- The financial risks inherent in any significant new funding partnerships,
- major outsourcing arrangements or major capital developments.
- The Council's virement and end of year procedures in relation to budget under/overspends.
- The availability of other funds to deal with major contingencies and the adequacy of provisions.

- The adequacy of the Council's insurance arrangements to cover major unforeseen risks.

An objective evaluation of these factors will be undertaken each year to determine a prudent level of general reserves cover based on an assessment of the above factors. However, the final level of reserves is ultimately subject to the Chief Finance Officer's judgment, taking all relevant factors into consideration.

As part of the annual budget recommendation to the Council, the Resources Committee will highlight the amounts that are being set aside for reserves.

6. Building Reserves
Should the Chief Finance Officer consider the level of General Reserves require increasing, this will be achieved as part of the budget setting process, establishing an allocation from the annual budget to achieve the desired level of balances.

Contributions to (or from) General Reserves should be reviewed annually. This will be additional to any amounts needed to replenish reserves that have been consumed in the previous year, to maintain the minimum level of reserves.

Earmarked reserves will be established on a "needs basis", in line with planned or anticipated requirements, and will be subject to Resources Committee approval, usually as part of an annual reserves report that goes as part of the Year End.

For each such reserve the Council will define:
- The purpose of the reserve.
- How and when the reserve can be used.
- Procedures for management and control of the reserve.
- A process and timescale for review of the reserve to ensure continuing relevance and adequacy. This will generally take place at year end.

7. Capital reserves

The current minimum level of capital reserves is £5m. The capital programme for 2014-15 fully utilises all available reserves down to the min level. The future expectation of capital receipts for strategic asset sales has not yet been built into the capital programme.

Good asset management strategies have included in them the replenishment of assets following on from strategic asset sales, so that there will be assets of a strategic value on the balance sheet for future years.

The capital receipts from such strategic assets sales are a valuable source of capital financing but equally a proportion of these proceeds need to be reinvested for either revenue return or for investment in other assets that over time will increase in value and form part of future year's capital financing.

As such 25% of all strategic asset sale capital receipts should be ear-marked for reinvestment, either for investment to produce future sources financing or to create a revenue income stream. A Capital Investment reserve will be created and on receipt of proceeds of sales a proportion will be added to this reserve. Capital schemes that either proposes reinvestment in assets or revenue income streams will be considered for funding from this ear marked reserve, to compliment the current capital programme schemes funded by general capital receipt reserves.

Similarly the capital funds allocated to Compulsory Purchase orders will be replenished from the capital receipts on the sale of the acquired properties. This will then form the basis of a rolling fund for the compulsory purchase orders issued.

8. Use of Reserves

Reserves can only be used once, and so should not normally be used to finance recurring planned spending – for example they would not normally be

used to "balance the budget".

Where reserves are used to support the delivery of the budget in any one year, for example to smooth funding fluctuations or pressures across years, the Council should ensure the reserves are replenished in the following year if necessary.

Where the Council has used general reserves for investment purposes to generate savings, these would also generally be paid back by the end of the following financial year. In exceptional cases, such as minimising the impact upon services to customers and citizens, more time would be allowed for replenishment, up to a maximum of four years, in line with the medium-term planning cycle.

Use of General Reserves will be subject to Resources Committee approval. The creation of earmarked reserves will also be subject to Resources Committee approval, but once this level of approval has been given, drawdowns against the reserve, will then be subject to the approval of the Service Head in liaison with the Chief Finance Officer to ensure the criteria for the use of the reserve has been met.
In extreme circumstances, where general reserves have been exhausted due to unforeseen spending pressures within a given financial year, the Council would be able to draw down from its earmarked reserves to provide short term resources, but this would not be sustainable, and balances would need to be restored.

Earmarked reserves that have been used to meet a specific liability would not need to be replenished, having served the purpose for which they were originally established.