

Report of Head of Finance

Reserves Policy 2016-17

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 As at 1st April 2015 the council held approx. £4m of general fund revenue reserves, £4.3m of earmarked revenue reserves: a total of approx. £8.3m total revenue reserves, and £12.6m of capital reserves.
- 2.2 These balances will have been utilised in the year and are currently estimated to be at approx. £7.5m of revenue reserves and £7m capital reserves at the end of the financial year. In addition to the capital reserves there is also a negative capital financing requirement that can be applied to fund the capital programme of £8.7m, bringing total capital finding available to approx. £15.7m. Anticipated large capital receipts may still be received. However, it is likely that these will now be in 2016-17 and so are not included in these figures.
- 2.3 In 2016-17 the revenue budget will be reliant on the use of approx. £619k of reserves to maintain a balanced position. In future years, if no further savings or efficiencies are identified, this reliance rises to approx. £1.3m per annum in 2019-20 and - at that rate of expenditure - the reserves will fall below the minimum level in 2018-19.
- 2.4 Capital funding is estimated to be £15.7m at the end of 2015-16. The current minimum level of reserves is set at £5m. This allows for approx. £10.7m of capital expenditure plus the addition of approx. £1.2m ongoing capital receipts each year, and potential to realise some assets to increase these receipts by a further £10m.
- 2.5 The use of reserves should be governed by a policy agreed by members and, as stated in the S151 officer's S25 report presented to this committee in February 2016, 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 level of revenue reserves as at 31 March 2015 and predicted year end reserves for 31st March 2016.

Appendix 2: Reserves policy

4 Proposed action: Members are asked to RECOMMEND to:

4.1 **Note the current reserves position at Appendix 1**

4.2 **Agree the Reserves Policy attached at Appendix 2.**

5 Background

5.1 This report presents a refresh of the policy on the use of reserves. The use and level of reserves will again be an essential part of the council's financial strategy for the coming year. In response to this the budget process for future years and the development of an efficiency plan should focus on reducing the reliance on reserves and ensuring the council's finances are sustainable.

5.2

5.3 This proposed level of change for the coming years also adds uncertainty and risks to the budget and the level of reserves should therefore reflect the S151 officer's opinion on the adequacy of reserves.

5.4

5.5 Although the level of general fund reserves is currently sufficient to support the revenue budget for the next few years, they are not renewable forms of finance and at some point in the medium term 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.

5.6

5.7 There are some significant capital receipts anticipated in the future but as these have not been received to date the level of resources available for use currently does not reflect them.

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5.9 The capital programme proposed for 2016-17 reflects the available resources at the current time but also recognises that as resources become available in the future the programme may be expended

5.10 .

5.11 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 create the maximum flexibility and value for the council, and position it for future sustainability and financial self-sufficiency.

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

6.3 The council recognises the need to hold and maintain reserves, but also recognises that by choosing to hold or increase reserves, it is allocating resources away from other potential uses. It is recognised therefore that 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.

6.4

6.5 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.

6.6

6.7 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 to ensure that there are key protocols for their establishment and use. The Chief Finance Officer has written a Section 25 report for the 2015-6 budget which details the consideration for the minimum level of reserves she feels is prudent and sufficient.

6.8

6.9 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.

6.10

6.11 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 .

6.12

6.13 The relevance of all reserves will be reviewed on an ongoing basis and formally reviewed on an annual basis as part of the year end reporting. Such a policy should be reviewed annually and this report constitutes the annual review for 2016-17.

6.14

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

6.16 **Changes to Reserves for 2015-16**

6.17 As part of the on-going review of reserves for 2016-17 a further new reserve is being proposed as follows:

6.18 An efficiency and transformational capital reserve in anticipation of the implementation of the flexible use of capital receipts direction from central government.

6.19 The new reserve will be an enabling fund for larger scale transformational projects to allow the council to find more efficient ways of working and financial self-sufficiency. This reserve will be increased if and when agreed by this

committee, and in line with the capital strategy

- 6.20 This will formally be reported for agreement in the Year-end financial reports which are to be presented to this committee in June 2016
- 6.21 Any other changes to ear marked reserves will be reported at the same time and reflect the risks and liabilities that the council faces for the coming years.

7 Legal powers

- 7.1 Sections 32 and 43 of the Local Government Finance Act 1992
- 7.2 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

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, stronger and safer communities and equalities

None

11 Author and contact officer

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12 Consultees

SMT

13 Background papers

CIPFA Bulletin: LAAP77 Reserves and balances

Transfers to/from Earmarked Reserves Note 8

Reserves	Balance 31st March 2014 £'000	Transfers in 2013/14 Restated £'000	Transfers out 2013/14 Restated £'000	Balance 31st March 2015 Restated £'000	Transfers in 2014/15 £'000	Transfers out 2014/15 £'000	Balance 31st March 2016 £'000
Budget Implementation Reserve	-993	-	352	-641	-	635	-6
Efficiency and Services Transformation	-362	-300	-	-662	-	-	-662
Organisational Property	-	-250	-	-250	-	-	-250
Broadband Infrastructure	-	-102	-	-102	-	-	-102
ICT Infrastructure	-	-36	-	-36	-	-	-36
Wollaston HWRC	-	-100	-	-100	-	-	-100
Welfare Reform	-250	0	-	-250	-	-	-250
Business Rates Retention	-709	-183	-	-892	-	-	-892
Leisure Services	-	-180	-	-180	-	-	-180
Collection Fund	-540	-	-	-540	-	-	-540
Property Service Charges	-210	-	88	-122	-	-	-122
Community Rights	-14	-16	-	-30	-	-	-30
Individual Electoral Registration	-9	-2	-	-11	-	-	-11
VAT Reserve	-121	-	-	-121	-	-	-121
Planning Reserve	-415	-	301	-114	-	95	-19
Miscellaneous Revenue Grants Reserve	-194	-34	21	-207	-	-	-207
Neighbourhood Dev Reserve	-7	-	-	-7	-	-	-7
New Burdens Impact Reserve	-	-16	-	-16	-	-	-16
Earmarked Reserves	-3,824	-1,219	762	-4,281	-	730	-3,551
General Fund	-4,109	-1,900	2,025	-3,984	-	-	-3,984
	-7,933	-3,119	2,787	-8,265	-	730	-7,535

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, such as 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, it is allocating resources away from other potential uses and there is, therefore, 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 main 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 risk of volatility in planning assumptions as we continue to go through uncertain economic times, or the risk of reductions in government funding at 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 is 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 a number of factors in determining the precise level of reserves, many of which involve an assessment of the risk of assumptions included in the Corporate Risk

Register and reflected 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 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 that the level of general reserves should be increased, 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 will be reviewed annually. This will be in addition 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 procedures.

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 level of available funding for capital schemes is assumed to increase over the next financial year. This therefore provides an opportunity to consider higher cost capital schemes that previously may have only been proposed if prudential borrowing was considered. As the higher level of funding available is likely to be committed to these schemes the current minimum level of capital reserves will remain in place. Should the risks change over the financial year then the level will be reconsidered if appropriate to do so. For now the Chief Finance Officer does not propose any change.

Good asset management strategies have within them the replenishment of assets following 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 years' capital financing.

A quarter of all strategic asset sale capital receipts will be earmarked for reinvestment, either for investment to produce future sources of financing or to create a revenue income stream. A capital investment reserve will be created and, on receipt of proceeds of sales, 25% will be added to this reserve. Capital schemes that either propose 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.

An efficiency and transformation capital reserve will be created and will be used to hold funds relating to the flexible use of capital receipts as detailed in the financial settlement from central government. No minimum level is required but similarly an indicative amount of at least 25% of all capital receipts in the relevant period is recommended. The amount of funds will be allocated by agreement at Resources Committee

8. Use of reserves

Reserves can only be used once, and so will 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 will 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 will 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 will be able to draw down from its earmarked reserves to provide short term resources, but this is not 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.

