

Executive

Review of Reserves

23 May 2011

Report of Head of Finance

PURPOSE OF REPORT

To seek endorsement from the Executive, following a review by the Head of Finance – in association with the Portfolio Holder for Resources – of the Councils revenue reserves, to determine whether they are set an appropriate level with regard to purpose, anticipated timing of need, degree of risk and level of potential expenditure.

This report is public

Recommendations

The Executive is recommended:

- (1) To consider and endorse the contents of this report.
- (2) To approve the transfers between earmarked reserves and the creation of 1 new reserve detailed in Appendix 1.
- (3) To approve that authority is delegated to the Head of Finance, in consultation with the Portfolio Holder for Resources, to transfer sufficient funds from earmarked reserves to general fund balances as part of the closedown processes for 2010-11 to avoid general fund balances falling below the minimum amount stated in the medium term financial strategy.

Executive Summary

- 1.1 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.
- 1.2 It is good practice to carry out an annual review of reserves. The reserves were reviewed initially in January 2011 as part of the 2011/12 budget process. Appendix A contains the second review to take account of movements in the final quarter and in conjunction with the year end closing.
- 1.3 There is also a requirement under Section 25 of the Local Government Act 2003 to ensure that the levels of reserves held are reasonable and adequate.
- 1.4 Section 25 of the Local Government Act 2003 requires the chief financial officer (the Head of Finance) to report on the adequacy of the proposed financial reserves.

- 1.5 The Head of Finance is satisfied that the level of reserves set out in Appendix A are adequate, appropriate and prudent.

Background Information

Policy

2. Purpose

2.1 Cherwell District Council is required to maintain adequate financial reserves to meet the needs of the organisation. The purpose of the reserves policy is to set out how the Council will determine and review the level of general fund reserves. The Council's general fund is where all the revenue income and expenditure of the Council is accounted for. It does not include specific funds such as the collection fund or the housing revenue account.

2.2 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. However, there is no specified minimum level of reserves that an authority should hold and it is the responsibility of the Chief Financial Officer to advise the Council about the level of reserves and to ensure that there are key protocols for their establishment and use.

2.3 Earmarked reserves are defined as follows:

*"A means of building up funds to meet known or predicted requirements."*¹

Therefore it is for the Council to determine the purpose of individual earmarked reserves in line with this definition.

2.4 This review of reserves has been carried out in accordance with the following best practice guidance, internal procedures and statutory requirements.

- Local Authority Accounting Practice (LAAP) bulletin 77 – Local Authority Reserves and Balances.

This guidance note was issued in November 2008 and replaces LAAP bulletin 55, which was previously used to inform this report. LAAP bulletin 77 was issued in reaction to the impact several external factors have had on local authority reserves and balances over recent years. Most notable events being the floods of 2007 and 2008 and the problems relating to the economic downturn which started in the latter part of 2008 and continue at the time of writing this report.

2.5 This report has been prepared in accordance with the most recent guidance contained in LAAP 77. A particularly relevant excerpt from LAAP 77 is detailed below:

"Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option. However, it is not normally prudent for reserves to be deployed to finance recurrent expenditure. Where such action is to be taken, this should be made explicit, and an explanation given as to how such expenditure will be funded in the

¹ LAAP77 – Paragraph 16

medium to long term. Advice should be given on the adequacy of reserves over the lifetime of the medium term financial plan, and should also take account of the expected need for reserves in the longer term.”

- 2.6 The Council's financial reserves policy will contribute to the achievement of all of the Council's strategic priorities.

3. Types of reserves

- 3.1 Reserves can be categorised as general (e.g. held to cushion the impact of uneven cash flows or unexpected events) or earmarked (held for a specific purpose).
- 3.2 Earmarked reserves are held for five main reasons:
- Renewals – to enable services to plan and finance an effective programme of vehicle and equipment replacement. These reserves are a mechanism to smooth expenditure so that a sensible replacement programme can be achieved without the need to vary budgets.
 - Trading accounts – In some instances surpluses are retained for future investment.
 - Insurance reserve – to meet the estimate of future claims to enable the Council to meet the excesses not covered by insurance.
 - 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.
 - Other earmarked reserves will be set up from time to time to meet known or predicted liabilities.
- 3.3 General reserves or working balances are funds which do not have any restrictions as to their use. These reserves can be used to smooth the impact of significant pressures, offset the budget requirement if necessary or can be held in case of unexpected events or emergencies.

4. Earmarked reserves

- 4.1 The Financial Regulations set out the framework for the use and management of 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.
- 4.2 Earmarked reserves will be established on a “needs” basis, in line with planned or anticipated requirements.
- 4.3 As outlined in the regulations, approval to set up a reserve must be sought from the appropriate Portfolio Holder and the report which seeks this approval must identify the purpose of the reserve and how it will be used.
- 4.4 Expenditure from reserves can only be authorised by the relevant officer, in conjunction with the Portfolio Holder of Resources and Chief Financial Officer.
- 4.5 Reserves can only be used once and so should not be held to fund ongoing expenditure. This would be unsustainable as, at some point, the reserves would be exhausted. To the extent that reserves are used to meet short term funding gaps, they must be replenished in the following year. However, 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.

- 4.6 All earmarked reserves are recorded on a central schedule held by Finance which lists the various earmarked reserves and the purpose for which they are held and shows the estimated opening balances for the year, planned additions/withdrawals and the estimated closing balance. This schedule of earmarked reserves is attached as Appendix 1.
- 4.7 CIPFA guidance on Local Authority Reserves and Balances advises that a statement reporting on the annual review of earmarked reserves should be made to Council, at the same time as the budget is approved.
- 4.8 Currently, the earmarked reserves held are reviewed twice per year by the Portfolio Holder of Resources and Chief Financial Officer. The result of these reviews is reported to the Executive and annually the review is reported to Council as part of the annual service and financial planning process.

Local Government Act 2003

- 4.9 Section 25 of the Local Government Act 2003 requires the chief financial officer (the Head of Finance) to report on the adequacy of the proposed financial reserves.
- 4.10 The Head of Finance is satisfied that the level of reserves set out in Appendix 1 are adequate, appropriate and prudent.

5. Working balances

- 5.1 The level of general reserves or working balances is a matter of judgement and so this policy does not attempt to prescribe a blanket level. The primary means of building working balances will be through an allocation from the annual budget. This will be in addition to any amounts needed to replenish reserves that have been consumed in the previous year.
- 5.2 Setting the level of working balances is one of several related decisions in the formulation of the medium term financial strategy and the annual budget. The Council must build and maintain sufficient working balances to cover the key risks it faces, as expressed in its corporate risk register.
- 5.3 For the last 2 years, the level of working balances has been maintained above a minimum level of £1.8m. This is based on an assessment of the possible impact on the Council's finances if a number of risks were to materialise. This level is reviewed annually as part of the Medium Financial Strategy refresh.
- 5.4 If in extreme circumstances general reserves were exhausted due to unforeseen spending pressures within a particular financial year, the Council would be able to draw from its earmarked reserves to provide short-term resources.

6. Changes to Reserves

- 6.1 The following section details the changes to reserves that are recommended as part of this report and gives a brief explanation of what they are being set up for. These movements can be seen in the highlighted column in Appendix 1.

Creation of New Reserves

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- 6.2 In a report to the Executive in February 2011 the Executive agreed to make available up to £50,000 to make a contribution to the fund being formed to campaign against the proposals and to fund consultancy work required to assist in the detailed assessment of the impact upon individual properties and communities along the Cherwell section of the preferred route.

This reserve has been created by transferring £50,000 from the planning reserve. The purpose of the planning reserve is to enable the Council to cover peaks and related fluctuations in expenses arising from variations in workload, major cases and special projects that are difficult to predict accurately. The expenditure must be related to planning issues. In particular the reserve allows for the heavy additional costs arising from major planning appeals, where it is necessary to employ specialist consultants and external legal representation.

Transfers between Earmarked Reserves

Insurance and Legal Claim Reserve

- 6.3 This reserve is used to fund insurance and now to include legal claims that are uneconomical to pursue or below contractual excesses. It has been assessed that a balance of £300,000 is required and the £50,000 increase has been funded from transfers in from Corporate ICT Contingency, Iceland Legal Costs and Corporate Change reserve.

Corporate ICT Contingency Reserve

- 6.4 This reserve is used to fund expenditure outside of the usual base line revenue and capital costs and can be used to fund equipment, specialist technical research and improvement projects. It has been assessed that a balance of £74,000 is required and the residual of £5,330 is transferred to the Insurance and Legal Claim reserve.

Corporate Change Reserve

- 6.5 This reserve is used to fund change initiatives to address either improvement issues, interim capacity or spend to save initiatives. As part of the second review it has been decided to set this at £450,000 and of the residual £39,370 a balance of £17,670 is transferred to the Insurance and Legal Claim reserve and the balance to the Joint Working Implementation Reserve.

Icelandic Legal Cost Reserve

- 6.6 This reserve was set at 1% of the claim - £65,000 – under review of reserves 1 it was thought that an additional top up of £27,000 was required to meet the costs of appeals. We have since received a summary of future costs and these can be covered in the original estimate so £27,000 is released and transferred to the Insurance and Legal Claim reserve.

Icelandic Write Off Reserve

- 6.7 This reserve was set in the first review of reserves and set up to cover the difference between the capitalisation direction received and the worst case value of assets as an unsecured creditor at 29%. This reserve has been reduced by £500 to reflect the final figures and this has been transferred to the Joint Working Implementation Reserve.

Joint Working Implementation Reserve

- 6.8 This reserve was set to fund our share of the implementation costs of the shared management team. It was initially funded through windfall income from the VAT Fleming claim. Budget reductions in 2011/12 will also be required to fund the implementation costs. A request has been made to the Secretary of State to seek to capitalise our share of these costs in order to preserve our level of revenue reserves. A decision is expected in Summer 2011 but pending this the reserve will be earmarked and as a result of this review of reserves a further £22,200 has been transferred in from the Corporate Change Reserve.

Key Issues for Consideration/Reasons for Decision and Options

The following options have been identified. The approach in the recommendations is believed to be the best way forward

- Option One** To endorse the review of reserves undertaken and the proposed adjustments.
- Option Two** To reject the recommendation above.

Consultations - Not Applicable

Implications

- Financial:** The financial implications are outlined in the report in full.
Comments checked by Karen Muir, Service Accountant, 01295 221559
- Legal:** Section 25 of the Local Government Act 2003 requires the chief financial officer (the Head of Finance) to report on the adequacy of the proposed financial reserves at least annually.
Comments checked by Nigel Bell
Team Leader – Planning & Litigation / Interim Monitoring Officer , 01295 221686
- Risk Management:** 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.
Comments checked by Karen Muir, Corporate System Accountant 01295 221559

Wards Affected

All

Corporate Plan Themes

An Accessible Value for Money Council

Executive Portfolio

Councillor James Macnamara
Portfolio Holder for Resources and Communication

Document Information

Appendix No	Title
Appendix 1	Reserves held at 31 March 2011 and Proposed Adjustments
Background Papers	
	LAAP Bulletin 77 – Local Authority Reserves and Balances Code of Practice on Local Authority Accounting in the United Kingdom Financial procedure rules Local Government Act 2003 Budget Report :Executive – February 7 2011
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