

## **ESSENTIAL REFERENCE PAPER E**

### **Reserves Policy**

#### **Why is a policy on reserves needed?**

1. A policy is needed to satisfy statutory requirements (Sections 32 and 43 of the Local Government Finance Act 1992) in connection with the calculation of the budget requirement when setting the council tax. The Local Government Act 2003 also requires the chief finance officer to review and report on the adequacy of reserves when a council sets its budget. The same Act empowers the government to set minimum levels of reserves in the event an authority fails to act prudently.
2. More generally, an agreed policy on reserves assists in medium term planning. The Chartered Institute of Public Finance and Accountancy issues guidance on reserves and balances. Updated guidance (superseding that issued in 2008) was issued in July this year. This reflects arrangements arising from the IFRS based Accounting Code of Practice as well as the impact of emergency events (e.g. Flooding/storms) and the current period of financial austerity; this policy is consistent with that guidance.
3. The format of the accounts introduced by the application of International Financial Reporting Standards gives more prominence to the movement of and balances held in reserves which are a key indicator of an organisation's financial health and resilience.

#### **What are reserves?**

4. Reserves are the accumulated surplus of income over expenditure on an accruals rather than cash basis of accounting. There can be, and usually is, a difference between the total of reserves and accumulated cash balances.
5. Reserves can be usable or unusable. Usable reserves represent resources that are available to meet future liabilities. Unusable reserves are those which arise from accounting regulations – capital revaluations and pensions for example –

and which relate to transactions which by statute cannot be put to or taken from the general reserve.

6. Accounting conventions differentiate between reserves and provisions; provisions being amounts charged to the income and expenditure accounts in respect of liabilities likely to be incurred from past events and where a reliable estimate of the liability is possible but where the timing and/or precise value of that liability is uncertain. The reserves to be held and principles to assess the adequacy of balances.
7. The Council will hold two types of reserve
  - General reserves – by way of a working balance to manage cash flows and limit the need for temporary borrowing and to provide a contingency for unforeseeable events and emergency spending;
  - Earmarked reserves – reserves set aside for a defined purpose to meet known or predicted future liabilities.
8. The Council will adopt a risk based approach in considering the adequacy of individual reserves and the aggregate of all reserves. In reviewing reserves both immediate and the medium term requirements and risks will be considered; in general the longer the planning time frame the greater uncertainty to be applied to assumptions.

**The general reserves:**

9. The Council will maintain:-
  - a general reserve fund balance adequate to meet the needs of an in year working balance and as a second level of contingency; plus
  - a general reserve adequate to provide a reasonable level of contingency and manage differences between the timing of any significant charges to the income and expenditure account and MTFP assumptions .

10. There is no single formula by which all relevant considerations can be captured to work out any minimum, optimum or maximum level of general reserves or reserves in aggregate. Set out below are a minimum and maximum assessment that might be expected to apply in “normal” times. In the event that the general reserve is likely to fall outside of these boundaries the Council will give consideration to the need for any corrective action.
11. Subject to the risk considerations set out below, the aggregate balance on these reserves, less the amount held in respect of the Building Control Account, should normally not be expected to fall below £3m. This minimum acknowledges the Council’s exposure to variable interest rates, the degree to which services are bought in by contract, the dependency on income streams with an in year degree of uncertainty, the absence of any specific insurance reserve, risks associated with all regulatory services, the recent track record of spending within budget, plus the potential for error in any financial forecast.
12. Since this minimum balance was set in 2010 the Council has accepted some additional risk in its treasury activity by placing a proportion of its investments for longer (4 years) to achieve an improved investment return. These and other factors will vary over time and so may cause the minimum level to vary.
13. In terms of a maximum level of reserve the maximum should not be expected to exceed the sum of:
  - (a) 40% of the budget requirement at the start of the year of account
  - (b) 2.5% of total assets in the last audited financial statements
  - (c) The sum of future planned withdrawals and/or contributions to the general reserve in the last approved MTFP
  - (d) Less any sum held as an insurance reserve

Note: at 31 March 2014 the above limit was as follows;

(a) 40% of £8.678m (2013/14) = £ 3.471m

(b) 2.5% of £130.41m (31/3/2013) =	£ 3.260m
(c) Future withdrawals from the general reserve	£0
(d) Insurance Reserve 31 March 2013	<u>-£ 0.010m</u>

Total	£6.721m
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The actual net aggregate balance March 2014	£8.016m
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14. The primary risks to be considered are the assumptions used to underpin the budget and medium term financial strategy and the judgement of the risk that those assumptions may prove to be wrong and the potential impact of variance from the assumption. The key assumptions to be considered are:-

- the potential volatility of government general and specific grants
- inflation and interest rates
- amount and timing of capital receipts
- delivery of planned efficiency and other savings
- expected growth in activity from demand led or discretionary expansion of services
- new partnerships and major capital schemes
- current and future availability of alternative sources of funding

### **Earmarked Reserves**

15. Earmarked reserves will be established only for well defined specific purposes and generally will be expected to be used within the period of the MTFP.

16. Where specific reserves are established to meet defined risks of indeterminate duration the need for and balance on the reserve will be reviewed and likelihood and impact assessment will be reassessed as part of the Council's strategic risk management processes.

17. At 31 March 2014 earmarked reserves totalled £8.374m. Additions to Earmarked reserves in 2012/13 totalled £2.322m

### **Reporting of reserves**

18. As a minimum, the annual budget report and the final accounts report will set out opening balances, expected or actual transfers to and from reserves together with closing balances. The Director of Finance and Support Services as S151 officer will comment on the adequacy of reserves in those reports.
19. During the year the adequacy of reserves will be reviewed as part of the health check monitoring in the light of any significant budget variances. If the balance on general reserves appears likely to move outside of the minimum boundary the need for corrective action will be considered in the next planned health check report or earlier if the Council's S151 officer so requires.

### **Governance arrangements in respect of reserves**

20. Arrangements for the governance of the use of general and earmarked reserves will be set out in Financial Regulations. Planned contributions to and withdrawals from specific reserves will be set out in the MTFP approved by the Council.
21. The Council has delegated approval of the Final Accounts to the Audit Committee and as a result prior arrangements by which the Executive might approve at any time the establishment of an earmarked reserve and appropriations thereto from unused approved budgets have been revoked given that the full Council will no longer be able to ratify or amend those decisions. Such transactions now require the prior consent of full Council.