STRATEGY FOR HOLDING & UTILISING RESERVES

Background

The Strategy for Holding & Utilising Reserves was compiled in 2014 upon request by Welsh Government. Following a review of the Council’s reserves during 2015-16, it has now been revised.

The following documents were taken into consideration in revising the Strategy and advice was sought from the Council’s Treasury Management Advisors:

- The CIPFA LAAP Bulletin 99 “Local Authority Reserves and Balances” (July 2014)
- The Welsh Government Guidance for Local Elected Members “Scrutiny of Local Authority Holding and Utilising of Reserves” (January 2016)
- The CIPFA Code of Practice on Local Authority Accounting in the United Kingdom (Annually updated).

Legislative Background

The requirement for financial reserves is acknowledged in statute. 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 are other safeguards in place that help to prevent Local Authorities from over-committing themselves financially. These include:-

- Chief Finance Officer’s duty to report on the robustness of budget estimates and adequacy of reserves when the Council is considering the annual budget requirement (Local Government Act 2003 section 25).
- Requirement for the Council to make arrangements for the proper administration of their financial affairs and that the Chief Finance Officer has responsibility for the administration of those affairs (Section 151 of the Local Government Finance Act 1972).
The requirements of CIPFA’s Prudential Code – the Code requires the Chief Finance Officer to have full regard to affordability when making recommendations about the Council’s Capital Programme. Such consideration includes the level of long term revenue commitments. In considering the affordability of the Council’s capital plans, the Chief Finance Officer is required to consider all of the resources available to the Council, estimated for the future, together with the totality of its capital plans and revenue forecasts for the forthcoming year and the following two years. Best practice is for medium term revenue forecasts across the public sector and this is achieved through the Medium Term Financial Plan (MTFP).

The Council’s external auditors will consider whether the Council has established adequate arrangements to ensure that the Council’s financial position is soundly based.

These requirements are reinforced by Section 114 of the Local Government Finance Act 1988 which requires the Chief Finance Officer, as holder of the “red card” to report to all the Authority’s Councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the Authority will not have the resources to meet its expenditure in a particular financial year. The issue of a Section 114 notice cannot be taken lightly and has serious operational implications. In this scenario, the Authority’s Full Council must meet within 21 days to consider the Section 114 notice and during that period the Authority is prohibited from entering into new agreements involving the incurring of expenditure.

The National Assembly for Wales has reserve powers to specify in regulations a statutory minimum level of reserves that will be used if authorities fail to remedy deficiencies or run down reserves against the advice of the Chief Finance Officer.

**Financial Position**

The Budget setting reports to Council on the 5th March 2015 and 10th March 2016 highlight that these Council budgets have been prepared against the backdrop of the most difficult financial settlements since its inception in 1996. The pressure on finances currently and for the medium term are intense. Therefore, the ability to retain reserves becomes essential and something that requires careful consideration.

The Council’s Medium Term Financial Plan (MTFP) 2016-17 to 2019-20 identifies a projected funding gap of £52.5m over the next four year period (worst case scenario) and the cost reductions/efficiencies of £42.8m and additional council tax income of £9.7 required to ensure balanced budgets. There are no plans within the MTFP to use any reserves to balance the budgets, but working with ongoing reductions in funding will require the effective management of reserves.
The impact of the projected funding gap on some services will be immediate, although the financial planning process has ensured that management, commissioning, procurement and general efficiency savings will make a significant contribution to bridging this. The key challenge going forward is to protect those services which impact upon the most vulnerable in our communities.

The Council is not only safeguarding its financial position by maintaining reserves, its plans to apply some of them strategically to fund the transformation programme should deliver the future cost reduction/efficiencies required in the MTFP. Reserves may also be used to support the Council’s drive to achieve the objectives in the Single Integrated Plan 2013-18 and its current Improvement Plan for 2015-16:

- **School Improvement** – we will challenge and support our schools to consistently improve learning outcomes and help children and young people reach their fullest potential, particularly at Key Stage 4 (GCSE).

- **Vulnerable Children** – we will build the capacity of schools and services to enable vulnerable children and young people to be safe at home and in school and reach their potential.

- **Regeneration & Town Centres** – we will enable, facilitate and deliver schemes that contribute to a competitive, productive and sustainable economy.

- **Reconfiguring Adult Social Care Services** – we will continue to change how we provide adult social care services to improve efficiency and sustainability.

- **Tackling poverty** – in line with Wales’ national priority, we will take a Pembrokeshire wide, co-ordinated approach across all departments to help prevent poverty, help people into work and mitigate the impacts of poverty.

**Use of Reserves**

CIPFA guidance suggests that balancing the Council’s annual budget by drawing on reserves may be viewed as a legitimate short-term option. However, it is not prudent for reserves to be deployed to finance recurrent expenditure.

Councils should be particularly wary about using reserves to deal with shortfalls in current funding and should only ever contemplate this as a one-off exercise, and only if the reserves held are deemed to be at a level more significant that prudently deemed to be required.
Types of Reserve

Reserves will be classified as **usable** – being able to support future expenditure, or **unusable** – being required for financial accounting purposes only.

**Usable Reserves**

There are four main types of usable reserve held by the County Council, in line with CIPFA guidance:

- **The Council Fund and Housing Revenue Account (HRA) Working Balances** are non-earmarked reserves, maintained to cushion the impact of emergencies, to offset the impact of uneven cashflow, and as a general contingency.

- **Earmarked Reserves** are maintained to fund predicted liabilities (revenue and capital*) and to provide resources for service improvement and delivery. Earmarked reserves are accounted for separately but remain part of the Council Fund (with the exception of the HRA capital reserve).

- **Ring-Fenced Reserves** such as the Schools Reserves are maintained to represent monies held on behalf of Schools under the Council’s approved LMS Scheme and the Private Finance Initiative (PFI). The **Housing Revenue Account (HRA) Reserve** (capital*) is maintained as part of the management of the 30-year HRA Business Plan.

- **The Capital Receipts Reserve** is maintained to hold the balance of unapplied usable capital receipts, grants and contributions.

*The capital reserves are maintained to provide additional funding for the planned Council Fund and HRA capital programmes, providing flexibility for the financing of capital investment. These reserves are fully committed to meet the planned cost of future capital investment. The 21st Century Schools capital reserve provide earmarked funding towards meeting the £75m cost of the Council’s contribution.

**Unusable Reserves**

- **Unusable Reserves** are maintained to comply with relevant accounting requirements.
Earmarked and Ring-Fenced Reserves

Risk Management Reserves

**Insurance** - The reserve is maintained to meet the Council's exposure to claims under its insurance arrangements, to provide flexibility to meet the volatility of the insurance market and to provide resources to take any measures required to improve the Council’s risk exposure position, given our exposure to self-insurance claims.

Annual contributions are made by services to the reserve and contributions are made from the reserve to the claims provision or service revenue accounts to meet the cost of identified and quantified claims or other appropriate expenditure.

**Winter Maintenance** – The reserve is maintained to meet the costs arising from the measures that may be required to combat the effects of severe weather.

Asset Renewal & Repair Reserves

**Property & Equipment** - The reserve is maintained for the renewal and major repair of the Council's property and equipment. Annual contributions are made by services to the Reserve.

**Carriageway Reconstruction** - The reserve is maintained to provide flexibility between financial years in the maintenance of roads, bridges and other municipal assets.

**Vehicles & Plant** - The reserve is maintained for the renewal and major overhaul of the vehicle and plant fleet. Contributions, effectively annual depreciation costs, are levied on users departments as part of the overall charges for use of the assets.

**Cleddau Bridge** - The reserve is maintained to meet the cost of the major upgrading and overhaul of the Bridge and its associated structures.

**West Wales Crematorium** - the reserve is maintained to meet the cost of major repair upgrading of the Crematorium facilities.

Equalisation Reserves

**Elections** - The reserve is maintained to equalise the 5-yearly cost of County Council election administration.

**Social Care Reorganisation** - The reserve is maintained to provide flexibility within this demand lead service and to mitigate substantial in-year movements.
**Education Reorganisation** - The reserve is maintained to meet the one-off costs associated with any Education reorganisation.

_Transformation Reserves_

**Invest to Save** - The reserve is maintained to provide resources to allow the Council to invest in the transformation of its services and to realise future cost reductions/efficiencies.

**Service Reconfiguration** - The reserve is maintained to provide resources to meet the one-off costs associated with any service reconfiguration.

_Service Delivery Reserves_

**Planning** - The reserve is maintained to accumulate funds towards the periodic costs of producing the Local Development Plan and other costs arising from Public Inquiries etc.

**County Farms Compensation** - The reserve is maintained to pay end of Tenancy Compensation payments.

**Regeneration Fund** - The reserve is maintained to provide funding and facilitate the delivery of regeneration projects.

**Economic Development & Tourism** - The reserve is maintained to provide funding for the delivery of economic development and tourism.

**Environmental Services** - The reserve is maintained to provide funding and facilitate the delivery of environmental services obviating fluctuations in annual budgets.

**Recycling** - The reserve is maintained to provide funding and facilitate the delivery of recycling services obviating fluctuations in annual budgets, e.g. The service is vulnerable to market price fluctuations.

_External Reserves_

**Joint Arrangements Reserve** - The reserve is maintained as it is required under financial reporting arrangements for Public Benefit entities and represents the amounts committed to fund joint working arrangements.

**Local Authority Mortgage Scheme** - The reserve is maintained to cover potential future defaults on the indemnified mortgages.

_Schools Ring Fenced Reserves_

**School ISB Balances** - This reserve is maintained to represent the School ISB balances held under the Council’s Local Management of Schools Scheme (LMS). Under guidance from Welsh Government, primary school balances are limited to £50k and secondary school balances are limited to £100k.
**Other** - The reserves are maintained for specific purposes under the LMS scheme. These include the Catering SLA and Maintenance SLA reserves and the PFI RSG equalisation reserve.

**Capital Receipts, Grants & Contributions Reserve**

Part of the receipts from the sale of Council assets are set aside to repay debt in accordance with accounting policies. The balances are available to finance capital expenditure, e.g. 21st Century Schools Programme.

Contributions for capital purposes and unapplied capital grants received are also available to finance future capital investment.

**Unusable Reserves**

The following financial reserves shall be maintained in accordance with Accounting requirements:-

- **Revaluation Reserve** - To record any net gain on fixed asset revaluation after 1st April 2007;

- **Capital Adjustment Account** - To reflect the difference between the cost of fixed assets consumed and the capital financing set aside to pay for them;

- **Financial Instruments Adjustment Account** - To reflect the discounting and other adjustments applied to financial instruments to arrive at amortised cost reported in the Balance Sheet;

- **PFI Lifecycle Reserve** - To reflect the estimated sums paid to the PFI contractor for keeping the asset in a “new” state and shall be matched by a prepayment on the Balance Sheet. Both accounts shall be written down based on information received from the contractor on the lifecycle expenditure incurred in the year.

- **Pension Reserve** - To reflect the position of the Scheme’s Fund.

- **Accumulated Absences Account** - To reflect the cost of paid absence entitlement due but not taken at 31st March.

- **Deferred Capital Receipts** - To reflect sale proceeds in respect of assets disposed of on a deferred basis.
Reserve Balances and Movements

The usable reserve balances and their predicted movement during the period 2015-16 to 2018-19 are shown at Annex A.

Only in the following circumstances are amounts allowed to be reserved from revenue:

- Material commitments exist for goods and services not received or paid for by 31st March.
- Facilitation of rolling over funding to future years to ensure the cost effective use of resources and allow for variation in service demand from year to year.
- To set aside resources for future developments or contingencies.

Expenditure financed from reserves will be shown, when incurred, under the appropriate service section in the Comprehensive Income & Expenditure Statement in the Council’s annual statement of accounts.

Appropriations to and from reserves will be reported in the Movement in Reserves Statement in the Council’s annual statement of accounts, separately identifying usable reserves the Council has approved for revenue and capital purposes, reserves held by Schools and unusable reserves.

Both the usable and unusable reserve balances at the start and end of each financial year are shown in the Balance Sheet in the Council’s annual statement of accounts.

Management of Reserves and Reporting

The reserves will be controlled and managed by the Chief Finance Officer (S151 Officer) or in his absence, the Head of Business Services (Deputy S151 Officer), in accordance with the existing statutory and regulatory framework.

Reserves will be used in accordance with plans included in the annual budget approved by Full Council or in exceptional circumstances to address urgent situations as deemed necessary by the Chief Executive or Chief Finance Officer.

The adequacy and appropriateness of the reserves will be assessed by the Chief Finance Officer during the budget estimate and final account (outturn) processes. Both the Cabinet and Full Council, as part of the budget approval process, will consider the rationale for keeping each reserve, the funds needed and projections for their use, with reference to the Council’s future spending plans.
Reserve balances and the predicted movement in reserves over the next three financial years will be reported to Full Council as part of the annual budget approval process.

Reserve balances and movement in reserves will be reported to Cabinet and the Overview & Scrutiny Committees as part of the quarterly integrated report. Any unplanned movements exceeding £100k will be clearly identified with a narrative description.

Requests for New Earmarked or Ring-Fenced Reserves

Any requests for new reserves must be requested by Directors and will require adherence to the following protocol:

- **Purpose of the Reserve** - The purpose of each reserve must be fully explained and included on an operational schedule that can be summarised for reporting purposes.

- **How and When the Reserve can be Applied** - When a reserve is established, the Chief Finance Officer will agree a protocol with the Director, where appropriate, that sets out how the reserve will be applied and over what period.

- **Responsibility for Management and Control** - The Chief Finance Officer is responsible for the management and control of all reserves and, in the case of service based reserves, will request a nominated service expert to advise on the appropriate use of the reserve and to provide management information as required.

- **Process and Timescale for Review** - The reserves will be managed as part of the quarterly financial reporting cycle and must be formally reviewed at least annually and in a timely manner to fit in with the budget setting process.

- **Decision Making Process** - All new reserves will be approved by the Chief Finance Officer but will be reported to Cabinet and Full Council as part of the reporting process (if required by legislation approval will be based on the requirements as set out in the relevant Act).

- **Reporting Requirements** - All new reserves must be supported by a business case, setting out the purpose of the reserve, the level of the reserve, the timescale for its application, the link to any Improvement Plan objectives and payback requirements where appropriate (if required by legislation the report will be determined by the requirements set out in the relevant Act).

- **Maximum Period for the Reserve to be Held** - All reserves will be subject to a maximum period of 3 years unless specific agreement is made at the time the reserve is established.
• **Minimum Value for Reserves** - It is not deemed necessary to establish new reserves for requirements that are below £50,000 as this is considered to be immaterial to the overall Council budget.

**Financial Indicators**

The Welsh Government Guidance for Local Elected Members “Scrutiny of Local Authority Holding and Utilising of Reserves” identified three key indicators for reserves which are detailed below. It should be noted that these indicators are not intended to be measures of good or poor performance but should be used to allow benchmarking, scrutiny and challenge of reserves.

**Usable Reserves as a Percentage of Gross Revenue Expenditure**

This indicator measures the relationship between an Authority’s usable reserves and its annual gross revenue expenditure. This excludes those reserves which are restricted for use by the authorities as indicated previously (i.e. HRA balances, schools balances and capital grants unapplied). Those reserves included in the indicator are:-

- Working Balances
- Capital Receipts Reserves
- Earmarked Reserves

**Earmarked Reserves as a Percentage of Gross Revenue Expenditure**

This measures the relationship between an Authority’s earmarked reserves and its annual gross revenue expenditure.

**Council Fund Working Balance Days Turnover**

This indicator measures the number of days an Authority would have financial cover if it needed to utilise solely the Council Fund Working Balance to fund day to day expenditure.

**Benchmarking**

An all Wales summary for the 2014-15 financial year is attached at Annex B for benchmarking purposes. However, it should be noted that when using the data for comparative purposes, the Council’s reserves include significant balances for the 21st Century Schools programme.

**The Way Forward**

Future reporting of reserves will incorporate management information in respect of the Financial Indicators and Benchmarking information.

*February 2016*