



**DRAFT**

## **Reserves Strategy**

**Version One**

**(June 2016)**

## 1. INTRODUCTION

- 1.1 This strategy document establishes a framework within which decisions will be made regarding the level of usable reserves held by the Council and the purposes for which they will be maintained and used. The strategy is underpinned by a detailed reserves protocol for the day-to-day operational management of reserves.
- 1.2 Local Authorities have a corporate responsibility to operate within available resources and to remain financially sound over the short, medium and longer term.
- 1.3 One of the key tools available to Authorities in managing their affairs is the creation and use of both general and earmarked reserves to assist them in delivering services over a period of longer than one financial year.
- 1.4 Reserves are an essential part of good financial management. They help Councils cope with unpredictable financial pressures, help them smooth the impact of known spending requirements over time, and help to fund any in-year overspending. The level, purpose, and planned use of reserves are important factors for Elected Members and Officers to consider in developing medium-term financial plans and setting annual budgets.
- 1.5 In terms of guidance on the review and management of reserves, the Chartered Institute of Public Finance and Accountancy (CIPFA), via the Local Authority Accounting Panel, issued a bulletin in July 2014 (LAAP 99) intended to give advice to Local Authorities on the management and review of reserves. This bulletin is considered best practice in terms of Local Authority financial administration of reserves and effectively must be followed. This strategy document incorporates the guidance and best practice set out in LAAP 99.
- 1.6 The Council holds reserves to support the sound financial management of the Authority. New reserves may be created at any time but must be approved in accordance with the Governance Framework set out in Section 6 of this document. Reserves set-aside must meet the following criteria: -
  - Create a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing e.g. an election reserve for dealing with the fluctuating expenditure levels resulting from cyclical elections, categorised as 'Equalisation Reserves'.
  - Create funds for specific policy purposes e.g. Capital Reserves to fund capital expenditure such as the 21<sup>st</sup> Century Schools Programme.
- 1.7 The Council keeps a number of reserves in the Balance Sheet. Some are required to be held for statutory reasons, some are needed to comply with proper accounting practice, and others have been set up voluntarily to earmark resources for future spending plans.

## **2. LEGISLATIVE / REGULATORY FRAMEWORK**

- 2.1 The requirement for financial reserves is acknowledged in statute. Sections 31A, 32, 42A and 43 of the Local Government Finance Act 1992 require billing and precepting Authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.
- 2.2 There are also a range of safeguards in place that help to prevent Local Authorities over-committing themselves financially. These include: -
- The balanced budget requirement (Sections 32 and 43 of the Local Government Finance Act 1992).
  - Chief Finance Officers' duty to report on the robustness of estimates and adequacy of reserves (under section 25 of the Local Government Act 2003) when the Authority is considering its budget requirement.
  - The legislative requirement for each Local Authority 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 Act 1972).
  - The requirements of the Prudential Code.
- 2.3 These requirements are reinforced by Section 114 of the Local Government Finance Act 1988 which requires the Chief Finance Officer to report to all the Authority's Elected Members 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.
- 2.4 Section 26 of the Local Government Act 2003 gives Ministers in England and Wales a general power to set a minimum level of reserves for Local Authorities. However, this is only applied to individual Authorities in circumstances where an Authority does not act prudently, disregards the advice of its Chief Finance Officer and is heading for serious financial difficulty. This accords with the view of CIPFA that a generally applicable minimum level is inappropriate, as a minimum level of reserve will only be imposed where an Authority is not following best financial practice.
- 2.5 Whilst it is primarily the responsibility of the Local Authority and its Chief Finance Officer to maintain a sound financial position, external auditors also have a responsibility to review the arrangements in place to ensure that financial standing is soundly based. In the course of their duties external auditors review and report on the level of reserves taking into account their local knowledge of the Authority's financial performance over a period of time. However, it is not the responsibility of auditors to prescribe the optimum or minimum level of reserves.

### **3. ROLE OF THE CHIEF FINANCE OFFICER**

- 3.1 In this document, all references to the Chief Finance Officer are to be taken to refer to the officer appointed by the Council, under Section 151 of the Local Government Act 1972, as responsible for the administration of the financial affairs of the Council. The officer currently designated as Chief Finance Officer for the Authority is the Acting Director of Corporate Services.
- 3.2 The Officer appointed under Section 151 of the Local Government Act 1972 has overall responsibility for providing financial advice on all budgetary and accounting matters affecting the Council's corporate financial affairs. They are also responsible for determining proper practice in terms of the Authority's accounting records and accounting control systems, and ensuring that the control systems are observed and the records kept up to date and properly completed.
- 3.3 Within the existing statutory and regulatory framework, it is the responsibility of Chief Finance Officers to advise Local Authorities about the level of reserves that they should hold and to ensure that there are clear protocols for their establishment and use. Reserves should not be held without a clear purpose.
- 3.4 In addition, the Chief Finance Officer also has to comply with professional standards in this regard, as detailed by CIPFA. In formulating such requirements, CIPFA has emphasised the Chief Finance Officer's fiduciary duty to local taxpayers, and the need to be satisfied that decisions taken on balances and reserves represent proper stewardship of public funds. These requirements include: -
- Advising Elected Members on the level of reserves, and establishing protocols for their use.
  - Reporting to Elected Members on the robustness of the budget, and the adequacy of reserves and provisions.
  - Reporting to Members on performance against budget and the impact on reserves.
  - An annual review of earmarked reserves (including schools' reserves).
- 3.5 A well-managed Authority with a prudent approach to budgeting should be able to operate with a level of general reserves appropriate for the risks (both internal and external) to which it is exposed. In assessing the appropriate level of reserves, a well-managed Authority will ensure that the reserves are not only adequate but are also necessary.
- 3.6 It is the duty of the Chief Finance Officer to specifically report on the robustness of budget estimates and reserves when Council considers the budget report in February each year. As such, the budget report will make specific reference to the level of and adequacy of reserves.
- 3.7 Within the context of the above statutory and professional responsibilities, the Authority's own Financial Regulations identify the Head of Corporate Finance as the officer delegated to manage the day-to-day operation of the Council's

financial affairs, with direct responsibility to the Chief Finance Officer. Within that role, the Head of Corporate Finance is responsible for the maintenance of the Authority's financial records, and for directing the form and method in which they are to be kept. The Head of Corporate Finance is also responsible for ensuring that the treatment of expenditure and income is in accordance with statutory requirements and professional Codes of Practice.

- 3.8 The Authority's Financial Regulations also state that all Heads of Service shall be responsible to the Head of Corporate Finance for the day-to-day operation of financial processes and procedures within their service area, and the accuracy and timeliness of any financial information or data. They are also responsible for consulting with the Head of Corporate Finance on all matters liable to affect the finances of the Council, and to provide all information necessary to enable the Head of Corporate Finance to carry out their role effectively.

#### 4. TYPES OF RESERVE

- 4.1 The definitions and related accounting treatment of reserves are governed by the requirements of accounting standards. In summary, reserves: -

- can be established for any purpose and at whatever point the Authority determines (although the purpose, usage and basis of transactions should be clearly established);
- can be held for both revenue and capital purposes; and
- can be used at the Authority's discretion (except that reserves established for capital purposes cannot be used to meet revenue expenditure).

- 4.2 Reserves are classified in specific categories. These are generally accepted classifications used by Local Authorities as follows: -

**General Reserves** – These apply separately in respect of the Council Fund and Housing Revenue Account (HRA), and essentially represent a combination of a working balance to cushion the impact of uneven cash flows, to avoid unnecessary temporary borrowing and to provide a contingency to cushion the impact of unexpected events or emergencies.

**Earmarked and Specific Reserves** – These are established to meet known or predicted requirements or are established by statute.

**Ring-fenced Reserves** – These reserves are set-aside for specific service areas (e.g. schools) and are not available for general Council use.

**Unusable Reserves** – These arise out of the interaction of legislation and proper accounting practice either to store revaluation gains or as adjustment accounts to reconcile requirements driven by reporting standards to statutory requirements. These reserves are not backed by resources (i.e. not cash backed) and cannot be used for any other purpose. Unusable reserves are outside the scope of this strategy document.

#### 4.3 General Reserves

4.3.1 The Chief Finance Officer will provide advice on the appropriate level of the General Fund Reserve annually as part of the budget setting process and this will be subject to approval by Cabinet and Full Council.

4.3.2 Directorates are currently permitted to hold 50% of revenue budget underspends in their own general reserves with the balance being transferred to the General Fund Reserve. The subsequent use of these Directorate reserves is subject to the approval limits set out in Section 6 of this document. Where a Directorate overspends in any given financial year, the overspend will in the first instance be chargeable to the retained underspend reserve for the Directorate.

4.3.3 The cumulative balance of the Directorate underspend reserves should not exceed 3% of the net revenue budget for each Directorate. Where the 3% limit is exceeded the reporting procedure outlined in paragraphs 6.8 to 6.10 of this document must be followed.

#### 4.4 Earmarked and Specific Reserves

4.4.1 These are required for specific purposes and are a means of building up funds to meet known or predicted liabilities. By their nature these reserve balances do not have minimum and maximum thresholds. The creation of such reserves must be approved in accordance with the thresholds set out in Section 6 of this document.

4.4.2 The most common reasons for establishing earmarked reserves include the following: -

- Major capital schemes or asset developments.
- Major reorganisations.
- Insurance related potential liabilities.
- Trading / business unit surpluses.
- Contingent liabilities.

4.4.3 Earmarked Reserves should be reasonable for the purpose held and must be used for the item for which they have been set aside. If circumstances arise in which the reserve is no longer required for its original purpose it will transfer to the General Fund Reserve.

#### 4.5 Ring-fenced Reserves

##### 4.5.1 Housing Revenue Account

The Housing Revenue Account (HRA) is ring-fenced which means that HRA resources can only be expended within the HRA. Councils are not allowed to transfer resources between the HRA and their general funds. The balance on the HRA is held in a ring-fenced reserve.

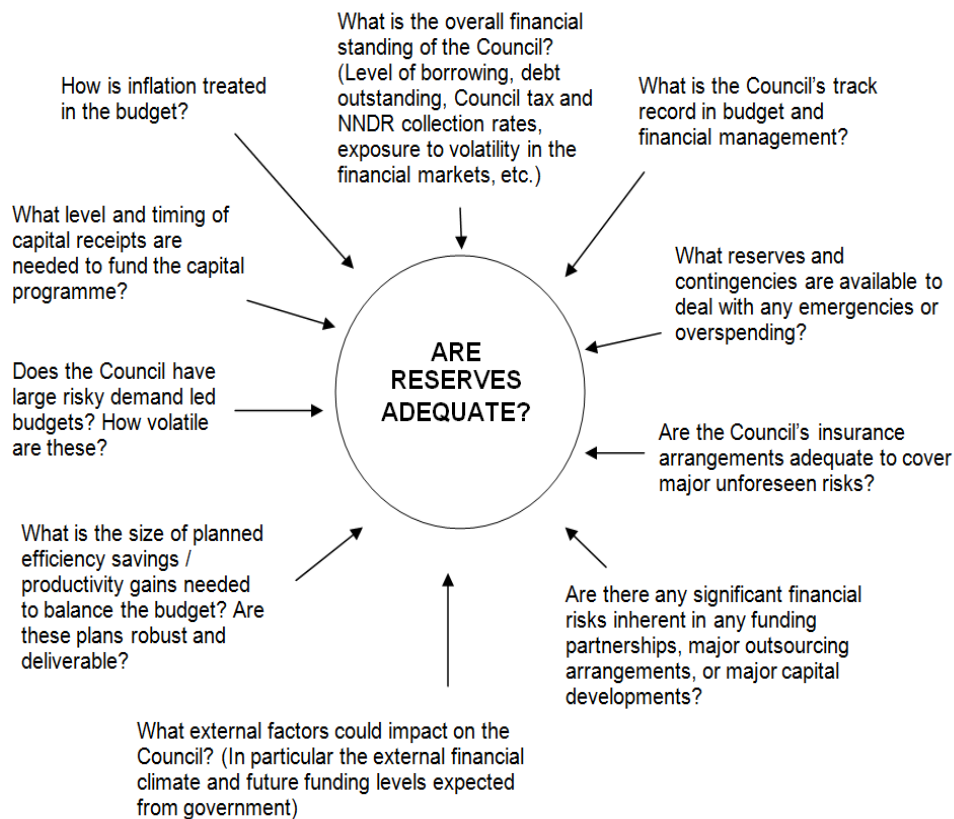
##### 4.5.2 Schools Reserves

Schools are able to carry forward surplus and deficit balances from one year to the next and utilise these balances for managing changes in pupil numbers and

funding, or the funding of projects and future liabilities. The balances are held by individual schools, they are not for general Council use.

## 5. PRINCIPLES TO ASSESS THE ADEQUACY OF RESERVES

- 5.1 There is no set formula for deciding what level of reserves is appropriate and Councils are free to determine the level of reserves they hold. Where Councils hold very low reserves there may be little resilience to financial shocks and sustained financial challenges. However, where reserves are too high there may be opportunity costs involved in holding these reserves (for example a lack of investment in making service changes that could generate better outcomes for residents and/or increased savings or revenue generation for the Council).
- 5.2 CIPFA guidance identifies the issues to consider in determining an appropriate level of reserves as follows: -



- 5.3 The many factors involved when considering appropriate levels of reserves can only be assessed properly at a local level. A considerable degree of professional judgement is required. The advice of the Chief Finance Officer will be set in the context of the Authority's risk register and medium-term plans and will not focus exclusively on short-term considerations.
- 5.4 It is not normally prudent for reserves to be deployed to deliver a balanced budget and CIPFA has commented that Councils should be particularly wary about using one-off reserves to deal with shortfalls in current funding. 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 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.

## 6. GOVERNANCE FRAMEWORK

- 6.1 Without a clearly defined purpose and approval process there will be ambiguity over the application of reserves. Therefore, when a reserve is proposed the following is the minimum information that must be provided: -

**Purpose** - The reason for creating the reserve should be clearly stated.

**Value** – Details of the amount that will be set-aside in the reserve and how it is being funded.

**Usage** - There should be a clear statement of how and when the reserve will be used.

**Management and Control** – Details of who will be responsible for the day-to-day management of the reserve and the associated reporting requirements.

- 6.2 The following are the authorisation limits for the establishment of reserves that currently operate within Caerphilly CBC (the limits are also applicable to the Housing Revenue Account (HRA)): -

### Revenue Reserves

Amount of Reserve	Approval By
Up to £20,000	Head of Service
£20,001 to £50,000	Portfolio Director
£50,001 to £100,000	Head of Corporate Finance and Portfolio Director
Over £100,000	Cabinet

### Capital Reserves

Amount of Reserve	Approval By
Up to £50,000	Head of Corporate Finance and Portfolio Director
Over £50,000	Cabinet

- 6.3 Details of each proposed reserve must be submitted to the Head of Corporate Finance in line with the minimum information requirements set out in paragraph 6.1 of this document. Arrangements will then be made for the appropriate approvals to be obtained and following approval the relevant financial transactions will be actioned in the Authority's accounts.



- 6.4 The authorisation process for the use of the General Fund Reserve will always be via Cabinet and Full Council.
- 6.5 Directorates will be expected to utilise their own reserves or existing budgets prior to seeking support from the General Fund Reserve.
- 6.6 When seeking approval for financial support from the General Fund Reserve, the relevant Director and/or Head of Service will present an appropriate business case to the Chief Finance Officer justifying the need to incur the expenditure and evidencing the extent to which the use of other funding sources has been investigated.
- 6.7 Where reports to Members are prepared, in accordance with the authorisation processes outlined in this document, the consultees must always include the Chief Finance Officer, Head of Corporate Finance and Finance Manager (Corporate Services), together with the appropriate Directorate Finance Manager.
- 6.8 Where the draft accounts in a given financial year show that the 3% limit on a Directorate's retained underspend reserve will be exceeded, the relevant Director will prepare a report for the Corporate Management Team (CMT) outlining proposals for utilising the excess balance. Alternatively, a CMT report will need to be prepared by the relevant Director providing a justification for retaining the excess balance as a contingency based on an up-to-date assessment of financial risks for the service. Whichever approach is adopted, the report must be considered by CMT within 6 months of the end of the relevant financial year.
- 6.9 Any proposals to utilise the excess balance that are supported by CMT will need to be formally authorised in accordance with the approval limits set out in Section 6 of this document.
- 6.10 Where proposals are not supported or no proposals are submitted for consideration, excess balances on retained underspend reserves will be transferred to the General Fund Reserve.
- 6.11 As mentioned in paragraph 4.5.2 of this document individual schools are able to carry forward surplus and deficit balances in ring-fenced reserves. However, the Local Authority does have a policy for managing both surplus and deficit school balances. Schools are required to report in writing to the Local Authority the use of surplus balances and the policy also allows a licensed deficit facility for schools that provide an action plan for bringing that deficit back into balance over a three year period. All schools with surplus balances are required to provide the Authority with plans of spend and these plans are monitored termly and reported to School Budget Forum at each meeting.
- 6.12 Clawback arrangements can be agreed by the School Budget Forum when school balances exceed prescribed limits, and in instances where spending plans are not adhered to. The prescribed limits from Welsh Government where clawback can be instigated are £50k for primary schools and £100k for secondary schools.

## **7. REPORTING ARRANGEMENTS**

- 7.1 The International Financial Reporting Standards (IFRS) based *Code of Practice on Local Authority Accounting in the United Kingdom (The Code)* introduced the Movement in Reserves Statement to Local Authority financial statements in the 2010/11 financial year. This Statement presents the movement in the year of the reserves of the Authority analysed into usable reserves and unusable reserves. The Code also states that for each reserve established, the purpose, usage and the basis of transactions should be clearly identified.
- 7.2 In addition to complying with the disclosure requirements in the annual financial statements the overall level of balances will be reported to Cabinet and Council annually as part of the budget setting and outturn reports. Any significant issues, including variations in the projected level of reserves, will be included in budget monitoring reports that are presented to Scrutiny Committees and Cabinet throughout the financial year.
- 7.3 Following the external audit of the accounts each year a report on usable reserves will also be prepared for the Policy and Resources Scrutiny Committee during the autumn. This report will provide detailed information on all usable reserves and will ensure that there is an opportunity for effective scrutiny of the balances held and their intended purpose.