

## Policy on Balances and Reserves

### Introduction

1. A key component of sound financial and risk management is that the Council maintains adequate reserves and balances to meet either known future commitments or expenditure arising from unforeseen, unexpected or emergency situations.
2. The purpose of this policy is to:-
  - outline the legislative and regulatory framework underpinning the creation, use and assessment of the adequacy of reserves;
  - identify the principles to be employed by the Financial Manager in assessing the adequacy of the Council's balances and reserves;
  - indicate how frequently the adequacy of the Council's balances and reserves will be reviewed
  - set out the governance arrangements relating to the creation, amendment and use of reserves and balances.
3. Accompanying this policy is a Strategy on the Use of Balance and Reserves which sets out how it is proposed to utilise the Council's current balances and reserves over the medium term financial planning period and as part of the Council's overall Financial Strategy.
4. In common with most local authorities, the Council maintains a range of reserves and balances. These can be analysed into two main types:
  - a) **Specific Reserves** – As the name suggests these represent amounts that are generally built up over a period of time which are earmarked for specific items of expenditure to meet known or predicted liabilities. Specific reserves are often used to 'smooth' the effects of certain expenditure commitments over a period of time thereby reducing the impact of significant expenditure in any one year.
  - b) **General Fund Revenue Balances** – This is often referred to as the 'working balance'. In effect this normally comprises two elements. The first is a sum of money which is not earmarked for specific purposes but rather set aside to deal with unexpected events or emergencies. Currently, using a risk based assessment, 'minimum working balance' has been established at £3.5m . Any amount held in excess of this is available to fund Spend to Save Schemes, subject to Executive approval.

### Legislative and Regulatory Framework

5. The requirement for financial balances and reserves is acknowledged in statute.
6. CIPFA<sup>1</sup> published guidance in 2003 in support of these matters and it is a requirement of the guidance, backed by legislation through provisions contained within the Local Government Act 2003 that the Council's Chief Finance Officer (at Pendle Borough

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<sup>1</sup> Chartered Institute of Public Finance and Accountancy

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Council this responsibility is held by the Financial Manager) reports on the robustness of, and plans to utilise the authority's reserves and balances. In addition there is a requirement to report to the full Council on the robustness of the Council's budget which includes a statement showing:

- The estimated opening and closing General Fund Revenue Balance for the year;
  - The estimated addition to and withdrawal from Balances.
7. The Section 151 Officer is also required to provide a statement on the adequacy of the General Fund Balance, Reserves and Provisions in relation to the forthcoming financial year and also over the medium term.
  8. In reporting generally on the reserves and balances, the Section 151 Officer is also required to report on the specific reserves of the Council, outlining the purpose for which each is held, establishing an appropriate level and highlighting any proposed changes during the forthcoming year.

## **Principles to Assess the Adequacy of Balances and Reserves**

9. Setting the level of balances and reserves is just one of several related decisions in the formulation of the medium-term financial strategy and the budget for a particular year. Account should be taken of the key financial assumptions underpinning the budget alongside a consideration of the authority's financial management arrangements. In addition to the cash flow requirements of the authority, the following factors should be considered:-

### *Budget Assumptions*

- treatment of inflation and interest rates
- estimates of the level of and timing and capital receipts and general cashflows
- treatment of demand led pressures (e.g. take-up of housing benefits)
- realisation of planned efficiency savings
- financial risks inherent in significant funding partnerships or major capital developments
- the availability of other funds to deal with major contingencies and the adequacy of provisions

### *Financial Standing and Management*

- the overall financial standing of the authority
  - the authority's track record in budget and financial management
  - the capacity to manage in-year budget pressures
  - the strength of financial information and reporting arrangements
  - the authority's financial procedure rules and budgetary flexibility
  - the adequacy of insurance arrangements to cover major unforeseen risks.
10. Fundamentally, the assessment of the adequacy of financial reserves and balances, and the decision whether there need to be any changes, will be undertaken within the context and extent of the financial risks faced by the Council.

## **Frequency of Reviewing the Adequacy of Balances and Reserves**

11. The frequency of reviewing the adequacy of balances and reserves is as set out in statute insofar, as indicated above, the Section 151 Officer is required to undertake a review, and report upon the adequacy, of balances and reserves at least on an annual basis.

12. However, the Section 151 Officer will, as part of the Council's normal budgetary monitoring procedures, undertake regular reviews of the need for the Council to create, use or replenish balances and reserves subject to any changes being considered by the Executive.

## **Governance Arrangements for Balances and Reserves**

13. The following governance arrangements will be maintained in relation to the Council's Balances and Reserves.

### Reporting Framework

14. The following reporting framework for Balances and Reserves will be maintained:-

- The policy on Balances and Reserves will be reviewed annually and reported to the Council as part of the budget setting process (February each year). This will include a statement from the Section 151 Officer on the adequacy of the General Fund Working Balance and Specific Reserves in respect of the forthcoming financial year and the Council's medium term financial plan.
- The strategy on the Use of Balances and Reserves will be reviewed annually and reported to the Executive as part of the Council's budget setting process. This will include a list of the various specific reserves, the purpose for which they are held and advice on an appropriate level. It will also show the estimated opening balance, planned additions/withdrawals and estimated closing balances over the medium term financial planning period.
- During the financial year, regular updates on changes to Balances and Reserves will be provided to the Executive as part of the Corporate Monitoring report.
- The Council's Statement of Accounts, which is reported to the Final Accounts and Audit Committee, will include a full analysis of Balances and Reserves as at the financial year end.

### Creating Reserves

15. New Reserves will be created in accordance with the scheme set out at 16 below.

### Utilising Balances and Reserves

16. The procedures underpinning the utilisation of Balances and Reserves are to be set out in the Council's Financial Procedure Rules, following the agreement of this Executive. The proposed text is:

*"The use of [balances and] reserves is to be considered as follows:*

- *Up to the 'risk level' – the full Council;*
- *Above the 'risk level' – the implementation of the full Council's policy, by the Executive;*
- *Specific Reserves (Earmarked Balances) - delegated to the S151 Officer of the Council. "*

17. Additionally, the Financial Procedure Rules will set out clearly the procedures for supplementary revenue estimates which, as they constitute a use of balances and/or

reserves, require the agreement of full Council.

## The General Fund Working Balance

18. The General Fund Working Balance will be held by the Council to cushion the impact of uneven cashflows and the impact of unexpected, unforeseen and emergency situations.
19. Annex 1.1 to this paper sets out the methodology which has been used to determine the minimum working balance and the following table analyses the individual components of the balance, for 2007-08:-

Item	£
Inflation (Price fluctuations)	362,306
Interest rate fluctuations	50,000
Grants	648,432
Infant Budgets	297,500
Demand led or volatile	165,875
Efficiency Gains, including Gershon	240,459
Insurance	36,891
Emergency Planning	1,039,647
Change	414,500
Financial guarantees/legal exposure	32,500
Unknown unknowns	200,000
<b>Total Minimum Working Balance</b>	<b>3,488,110</b>

Note: rounded to £3.5m

20. The adequacy of the minimum working balance will be reviewed, and if necessary updated, on an annual basis.

## Specific Reserves

21. Specific Reserves will be created and maintained, in accordance with the procedures set out in the Council's Financial Procedure Rules, as a means of providing for known and/or predicted liabilities.
22. As with the minimum working balance, the adequacy of specific reserves will be reviewed annually in accordance with statutory requirements.
23. Annex 2.1 of this report provides a brief summary of each of the Council's current specific reserves.

## Other Information

LAAP Bulletin 55 – Guidance Note on Local Authority Reserves and Balances  
Local Government Act 2003

## Annexes

Annex 1.1 The Level of General Fund Working Balance

## Annex 1.1 The Level of General Fund Working Balance

### Introduction

2. CIPFA considers that a case for introducing a statutory minimum level of reserves, even in exceptional circumstances has not been made. The Institute believes that Local Authorities, on the advice of their Chief Finance Officers, should make their own judgements on such matters taking into account all the relevant local circumstances. Such circumstances vary and there is a broad range within which authorities might reasonably operate depending on their particular circumstances.
3. There is no definitive guidance as to the minimum level of balances or reserves, either as an absolute amount or as a proportion of expenditure, since each local authority is independent, operates in a unique local environment and the decision is one of a number of inter-related decisions taken as part of its financial strategy. Section 32 of the Local Government Act 1992 requires billing authorities (such as NWDC) to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement. Budgets are based upon forecasts of pay and price inflation, changes in interest rates, and the demand for and levels of service to be provided.
4. The existence of balances provides for unexpected changes from these forecasts. Consequently the provision of an appropriate level of balances is a fundamental part of prudent financial management over the medium term.

### **What is an appropriate level of General Fund Minimum Working Balance for North Wilts District Council ?**

The attached paper was adopted by full Council on February 22<sup>nd</sup> 2007.

## Definitions of risk for Reserves

### 1 Background

1.1 There are two approaches for deciding the optimum level of Reserves. Either a percentage of expenditure, which at one stage was defined by the Audit Commission at 5% of net expenditure, or an approach based on a risk assessment of the budget.

This paper sets out the framework for a risk assessment approach. The issues the framework considers include the following:

- The Council will need to budget for provision for the cost of any redundancies necessary to achieve any budget savings and restructuring to the extent they are not contained in the budget proposals. The Council's policy is that redundancy costs are contained in the budget proposals.
- There is always some degree of uncertainty over whether the full effects of any economy measures and/or service reductions will be achieved. Strategic Managers have been requested to be prudent in their assumptions and that those assumptions, particularly about demand led budgets, will hold true in changing circumstances.
- The Bellwin Scheme Emergency Financial Assistance to Local Authorities provides assistance in the event of an emergency. The local authority is able to claim assistance with the cost of dealing with an emergency over and above a threshold set by the Government (NWDC's threshold for 2006-07 has been set at £27,481, 0.2% of budget). The assistance is usually 85% of any eligible costs over the threshold. Any incident for which assistance is sought must involve over conditions, which are clearly exceptional by local standards and the damage to local authority infrastructure or communities must be exceptional in relation to normal experience. In the first instance these initial costs will have to be met from reserves.
- The risk of major litigation, both currently and in the future.
- Risk of changes from hypothecated grant to unhypothecated Formula Spending Share.
- The unpredictability of the Formula Grant in the latter two years, which await the Spending Review 2007 announcements.
- The risk of losing subsidy arising from outstanding Housing Benefit and Council Tax Benefit Subsidy claims
- The risk of grants being introduced mid-year that require the Council to contribute.
- Unplanned volume increases in major demand led budgets, particularly in the context of high and accelerating growth.
- Potential short term differences between the Council's Insurance Reserve and outstanding liabilities, although these should be remedied in the following fiscal year.
- The need to retain a general contingency to provide for any unforeseen circumstances, which may arise.
- The need to retain reserves for general day to day cash flow needs.

## The Framework

2.1 The basis of the Framework is an area of risk, a budget amount, an assessed level of risk (high, medium, low), a percentage factor, which will vary according to the level of risk, which produces a value. The total of the value column, is the level balances required to cover the identified risk. The following example illustrates the text:

Salaries budget: £12.6m Risk: low Factor: 0.50% Value: £63.1k

2.2 The ten areas of risk are set out in the following table, with an explanation of what risk is being covered.

**Table 1: Ten Areas of risk for NWDC**

No	Area of risk	Explanation of risk
1	Inflation on expenditure	There are two issues. Firstly, there may be some items of expenditure – fuel costs for example - where any estimate of inflation is a ‘best guess’. The risk assessment puts a figure to the higher level of inflation that would seem to be unreasonable to include in a budget, but might come to pass. Secondly, information is less accurate for years 2 and 3; the risk assessment covers the higher range.
2	Interest rates on borrowing and investment	This is similar to 1 above, but for an specific area.
3	Grants, RSG, LABGI, PDG, Housing Benefits	The Government planning system is often short-term and a ‘best guess’ has to be offered in lieu of hard facts. Currently there are 4 issues: <ul style="list-style-type: none"> <li>• RSG for 2008-10 will firm up when Spending Review 2007 is announced in the summer of 2007.</li> <li>• LABGI will always be problematic given that announcements are made after the budget has been set.</li> <li>• PDG is an example of a grant in transition (downward), but who’s distribution is a mystery.</li> <li>• Housing Benefits – whilst the administration grant is straightforward, the subsidy is subject to audit and, sometimes, abatement.</li> </ul>
4	Infant (estimated) budgets, (Inc or Exp) <ul style="list-style-type: none"> <li>• Job Evaluation</li> <li>• Reorganisation incl redundancies</li> </ul>	There are some initiatives that are known will happen, but are not sufficiently advanced to accurately cost.
5	Volume changes - Demand led or volatile budgets (I or E) <ul style="list-style-type: none"> <li>• S106</li> <li>• Land sales</li> </ul>	Equally, there are long standing areas of risk, that have an exciting existence – we budget for the middle of the range, but might find the actuality is at the higher end.

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No	Area of risk	Explanation of risk
	<ul style="list-style-type: none"> <li>• Collection Fund</li> <li>• Land Charges</li> <li>• Planning charges</li> </ul>	
6	Efficiency gains incl Gershon savings	The budget includes improvement programmes that will deliver savings; the risk is that they may be delivered at a slower rate.
7	Insurance, funds and excesses	Acts of God can result in higher insurance traffic than had been anticipated.
8	Emergency planning – Belwin, disaster recovery, snow days	Were a disaster to occur, we have to have a reserve in place to pick up costs that will fall to the Council.
9	Change (I or E) <ul style="list-style-type: none"> <li>• Financial systems</li> <li>• Instalment date</li> <li>• NWLL</li> <li>• Parking charges</li> <li>• White Paper</li> <li>• Lyons report</li> <li>• Local Land Tax</li> </ul>	Change necessarily means doing things in a way for which we have no evidence. Our assumptions may be wrong. Also, the areas of change will alter over the years.
10	Financial guarantees /legal exposure <ul style="list-style-type: none"> <li>• PFI</li> <li>• WCC over NWLL</li> </ul>	The contract for the Council's offices would contain obligations that if not fulfilled, would attract a penalty.
11	Unknown unknowns	A specific item for anything not covered above

2.3 Risks can change over time. The three year budget approach will identify this, and produce a different Reserves requirement for each year. What might be an excessive level of Reserves in Year One, might be inadequate for Years Two or Three. Reserves have to be looked at over a three year period.

2.4 The issue of “unknown, unknowns” was raised at the January 18 Budget & Strategy Working Party. This is a difficult concept - for example, hard to quantify - that has to some extent been covered by the inclusion within the calculation of £500k for “other Disaster Recovery” and throughout the calculation, preferring to shade the risk at the higher end for reasons of prudence. However a sum of £200k is proposed, to recognise the concept and, review at a later date when there is evidence of performance against the risks.

2.5 This approach will be extended to the capital programme.



## 3 Outcomes

- 3.1 As a consequence, it is recommended that the minimum prudent level of general fund reserves is £3.5m for 2007-08 and, an optimal level of the same, over the medium term. The summary of the calculation is set out below. The detailed calculation is available on request.

### Risk calculation for the level of Reserves

	2005/06 Actual	2006/07 Actual	2007/08 Estimate	2008/09 Estimate	2009/10 Estimate
<b>1 Inflation</b>	320,269	348,372	362,306	376,799	391,871
<b>2 Interest Rates</b>	50,000	50,000	50,000	50,000	50,000
<b>3 Grants</b>	476,834	574,308	648,432	409,415	266,232
<b>4 Infant budgets</b>	0	0	297,500	155,000	0
<b>5 Demand led or volatile</b>	165,875	165,875	165,875	165,875	165,875
<b>6 Efficiency Gains incl Gershon</b>	211,782	231,211	240,459	250,078	260,081
<b>7 Insurance</b>	36,250	36,563	36,891	49,735	62,597
<b>8 Emergency Planning</b>	1,035,054	1,038,493	1,039,647	1,040,837	1,042,062
<b>9 Change</b>	0	111,800	414,500	589,500	414,500
<b>10 Financial guarantees/legal exposure</b>	12,500	12,500	32,500	32,500	22,500
<b>11 Unknown unknowns</b>			200,000	200,000	200,000
<b>Total</b>	<b>2,308,565</b>	<b>2,569,120</b>	<b>3,488,110</b>	<b>3,319,739</b>	<b>2,875,717</b>
<b>Movement</b>		<b>260,555</b>	<b>918,990</b>	<b>(168,372)</b>	<b>(444,021)</b>
Balance March 2007 predicted at Feb 16			3,577,000		
Excess			78,890		